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AUTHOR Shapiro, Isaac; Greenstein, Robert

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ABSTRACT

Poverty is an important antecedent factor affecting education. One of the most striking characteristics of rural poverty is the extent to which the rural poor work. About 65% of poor nonmetro families have at least one worker, compared to 54% of poor metro families. This report focuses on federal and state policy reforms that would assure poor rural workers a reasonable return for their efforts. The federal earned income tax credit (EITC) assists low-income families that have earnings and a child living at home, and the credit is "refundable" for families whose credit exceeds its income tax liability. Current proposals would expand the EITC for families with several children or young children. An outreach program is needed to inform low-income working families that they must file a federal tax return to receive the EITC payment. Raising the minimum wage to $5.02 in 1991 would restore its value lost to inflation during the 1980s and would benefit a majority of poor workers. Other strategies to aid the nonmetro working poor are: (1) making the federal dependent care tax credit refundable; (2) removing working poor families from state income tax rolls or establishing state EITCs; (3) restoring unemployment insurance coverage, which has dropped sharply in recent years; (4) extending Medicaid coverage to children in poor working families; and (5) instituting outreach programs to inform poor working families of their eligibility for food stamps. (SV)

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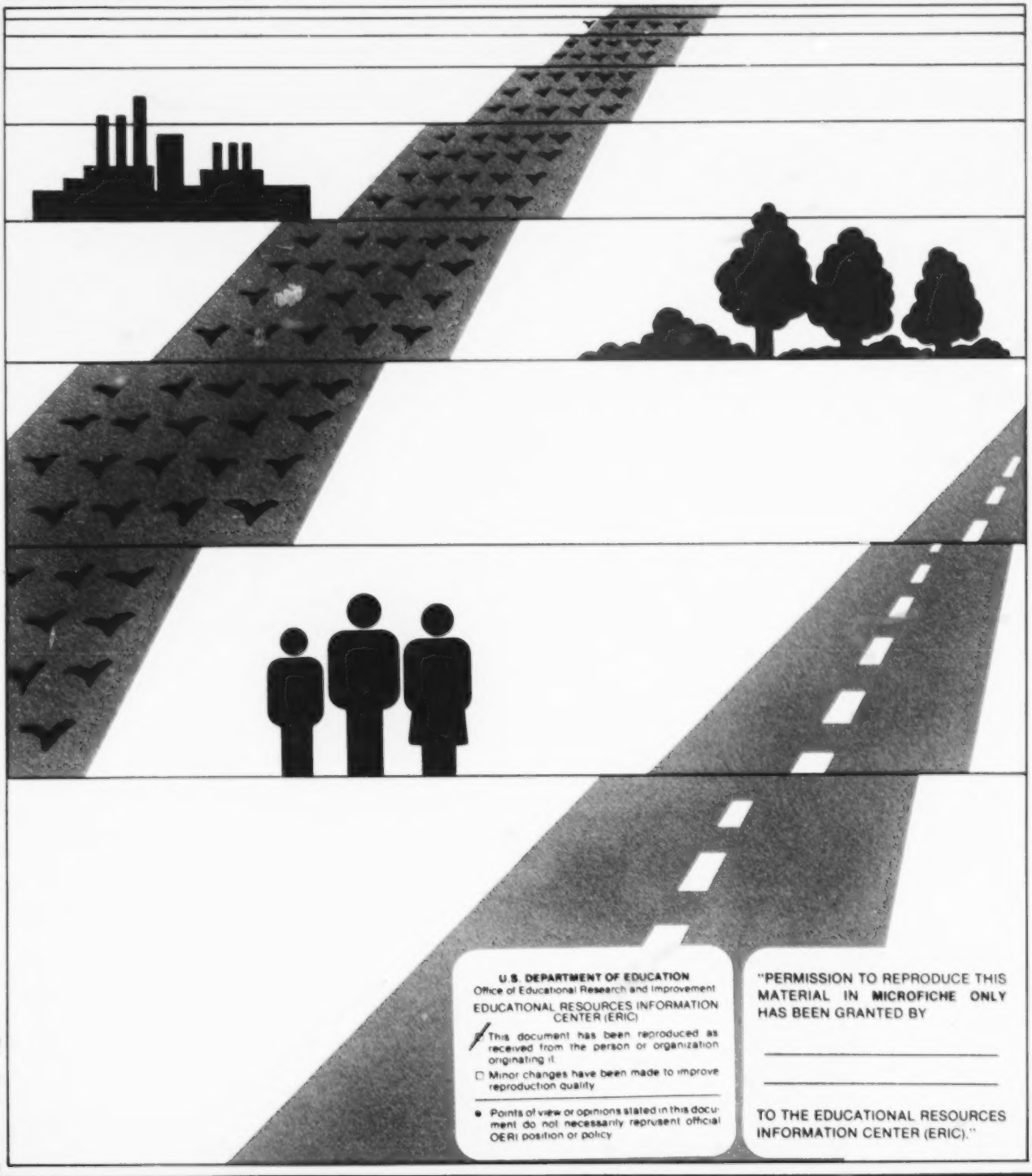
FULFILLING WORK'S PROMISE

Policies to Increase Incomes of the Rural Working Poor



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FULFILLING WORK'S PROMISE

Policies to Increase Incomes of the Rural Working Poor

Isaac Shapiro and Robert Greenstein

CENTER ON BUDGET AND POLICY PRIORITIES
Washington, D.C.

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About the Authors

Isaac Shapiro is a senior research analyst at the Center. He specializes in employment-related issues and is the co-author with Sar A. Levitan of the recent book, *Working But Poor: America's Contradiction.*

Robert Greenstein is the founder and director of the Center on Budget and Policy Priorities. A former administrator of the Food and Nutrition Service in the U.S. Department of Agriculture, he has written extensively on poverty in the United States.

February 1990

Center on Budget and Policy Priorities
236 Massachusetts Avenue, N.E., Suite 305
Washington, D.C. 20002
(202) 544-0591

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Preface

This is a companion report to the recently released Center analysis *Laboring for Less: Working but Poor in Rural America*. The earlier report examined the problems of the working poor in nonmetropolitan areas. It found that it will take a combination of public and private sector actions, as well as actions by the working poor themselves, to address their problems adequately.

This report concentrates on public sector efforts to address the problems of the nonmetro working poor. It examines various federal and state policy reforms designed to assure that those in rural areas who work receive a reasonable return for their efforts.

Some of the policy options recommended here, such as an increase in the earned income tax credit for low income working families with children, gained bipartisan support in Congress in 1989 and could conceivably be enacted, at least in part, in 1990. One other policy option examined here, restoration of the value of the minimum wage, was partially adopted in the fall of 1989.

These developments reflect a growing recognition among policy-makers that millions of the poor are working but remain well below the poverty line. The developments also reflect a growing understanding that increasing the returns from employment for the poor -- or "making work pay" -- sends a message that work is a viable route out of poverty.

This report focuses principally on policies that would raise directly the incomes of nonmetro workers who are poor. The report is guided by a basic goal: *full-time work should provide an escape from poverty.*

Most of the policies considered here involve income-based approaches outside the welfare system. Included are policy options involving federal and state tax reforms, changes in the minimum wage, and revisions in unemployment insurance policies. The report also briefly examines extending Medicaid health insurance coverage to more working poor households and informing such households of their potential eligibility for food stamps.

The policy options described here do not, of course, constitute the entire array of government policies that affect the working poor. For example, a low unemployment rate is a necessary part of any effort to reduce nonmetro poverty, and the economic policies of the federal government influence the unemployment rate. In addition, the nonmetro working poor are affected by policies relating to education and job training programs. Policies to increase the availability of quality day care services at prices affordable to the nonmetro working poor are also of major significance.

While the income-based strategies described here do not, by themselves, represent the full agenda for addressing the problems of the rural working poor, they are a core element of this agenda.

Acknowledgments

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The Center on Budget and Policy Priorities is grateful to the Rural Poverty and Resources Program of the Ford Foundation and the Rural Economic Policy Program of the Aspen Institute, whose support made preparation and publication of this report possible.

The authors claim sole responsibility for the contents of the report.

Executive Summary

This report examines various federal and state policy reforms designed to reduce poverty among people in rural areas who work but remain poor. The report focuses on *income-based strategies* and does not attempt to cover other areas where policies are needed to assist the rural working poor, such as efforts to increase the supply of affordable, quality child care, and efforts to improve education and job training programs. The report is a companion report to the Center's recently released analysis *Laboring for Less: Working but Poor in Rural America*.

The Rural Working Poor

One of the most striking characteristics of rural poverty is the extent to which the rural poor work. Nearly two of every three poor families living in rural areas include at least one worker, and nearly one in four such families have two or more workers.

Although many of the poor in metropolitan areas also work, the proportion of the poor who work is significantly larger in nonmetro than in metro areas. ("Nonmetro" and "rural" are used synonymously in this report.)

- While more than half -- 54.1 percent -- of poor metro families had at least one person who worked in 1987, some 64.7 percent of poor nonmetro families did.

Many of the rural poor families that do *not* have any workers are families in which the only adults are elderly or disabled.

Moreover, the incidence of poverty among nonmetro workers is higher than it was in the late 1970s. Poverty rates among nonmetro workers in 1987 can be appropriately compared with poverty rates in 1978. Both years were advanced stages of economic recoveries. In addition, the national unemployment rate was similar in both years.

Yet while unemployment rates were similar, poverty rates were not. In 1987, the poverty rate for nonmetro families in which the family head worked was 10.0 percent -- or nearly one-third higher than the 7.6 percent rate in 1978.

Among all types of working families, poverty rates are about *twice as high* in nonmetro as in metro areas.

The Strategy: Make Work Pay

A strategy can be devised consisting of a series of measures -- outside the welfare system -- designed to achieve a fundamental goal: *if a parent works full time, the family should not have to live in poverty.* In other words, the goal is to "make work pay" enough that a working family is not poor. This goal is consistent with the basic values of this country. In the past two years, it has been espoused by a growing number of liberals and conservatives alike.

Since a larger fraction of the nonmetro poor than of the metro poor are employed, policy initiatives to "make work pay" would raise the incomes of a larger fraction of the poor in nonmetro than in metro areas.

In addition to providing essential income support to the working poor, a "make work pay" strategy could strengthen work incentives, bringing more people into the labor market and making work relatively more attractive compared with public assistance. Analyzing the policy components that constitute a "make work pay" strategy is the focus of this report.

Federal Tax Policies

The Earned Income Tax Credit

The federal earned income tax credit assists low income families that have earnings and at least one child living at home. The credit has developed into a significant source of support for such families. In 1989, working families with incomes up to $19,340 were eligible for the credit, which provided a maximum benefit of $910.

A key feature of the credit is its "refundability." This means that if the credit for which a family qualifies exceeds the family's income tax liability, the family receives a check from the Internal Revenue Service for the difference.

The credit is widely regarded as strongly "pro-family." It is extended only to families in which parents live with and support children. The credit is also "pro-work": adults who do not work do not qualify. In addition, the EITC rises with earnings for the very poor, rather than declining as earnings increase (as welfare payments do).

Moreover, the EITC is particularly well-suited to the nonmetro poor. Since the nonmetro poor are more likely to work than the metro poor, the nonmetro poor are overrepresented among the program's beneficiaries. In addition, the manner in which EITC benefits are distributed suits the needs of the nonmetro working poor.

EITC Well-suited to Nonmetro Working Poor

1. Nonmetro working poor overrepresented among EITC beneficiaries.
2. No stigma attached to receiving EITC benefits.
3. No geographic accessibility problems to receiving benefits.
4. Does not require additional state funds from poor rural states.

The idea of expanding the EITC has gained an impressive number of conservative and liberal adherents. One reason for this is that working poor families with several children face a difficult situation today. Family needs increase as family size grows, and welfare benefits rise with family size. But wages do not. As a result, low wage working families with several children tend to fall further below the poverty line than smaller families -- and their wages are less competitive with public assistance benefits.

What is needed is a wage supplement for working poor families that is geared to family size. The EITC does not now provide different levels of benefits to families with different numbers of children, but it could be easily adapted to serve this purpose.

A number of proposals along these lines were introduced in Congress in 1989. One significant proposal passed the House of Representatives with bipartisan support but further action was deferred until 1990. The proposal would substantially increase the assistance provided by the EITC and would adjust EITC benefits to reflect the number of children in a family, up to three children. It also would provide an additional EITC supplement for families with young children. Overall, for example, it would nearly double the credit for families with two children, one of whom is less than six years of age.

One problem with the current EITC is that some working families who are eligible may not file a federal income tax return, which is necessary to receive the EITC payment. They may not file because they owe no federal income tax and are unaware of the credit. As a result, outreach activities are needed to insure that low income working families with children are aware of the need to file a federal income tax return to receive the credit.

The Dependent Care Tax Credit

The benefits of working can be greatly diminished by the high cost of child care. The federal dependent care tax credit provides a tax subsidy to reduce the child and dependent care costs of working families. But the credit fails to assist the very group that needs child care assistance the most -- working poor families. The reason is that the credit is *not* refundable. Those too poor to owe federal income tax (nearly all of the working poor fall in this category) receive no credit payment. By contrast, families at higher income levels do receive the credit; it is used to lower their income tax liability.

- An Urban Institute analysis has estimated that only three percent of all assistance provided through the dependent care credit goes to families in the bottom 30 percent of the income distribution.

An obvious remedy is to make the dependent care tax credit refundable, a proposal endorsed by President Bush and a number of members of Congress. Other reforms to the day care system -- such as policies to improve the quality of care -- also are important but are beyond the scope of this report.

Like expanding the EITC, making the dependent care tax credit refundable would assist the nonmetro working poor without being stigmatizing. In addition, it does not require trips to government assistance offices that may not be readily accessible.

State Income Taxes and the Nonmetro Working Poor

Since rural poor families are more likely to have earnings than are their urban poor counterparts, state income taxes on working poor families are likely to hit a larger proportion of the rural poor.

The federal Tax Reform Act of 1986 removed working poor families from the federal income tax rolls. Since then, a number of states – but not the majority -- have followed the federal lead and removed working poor families from state income tax rolls.

Among the states that have income taxes but do not tax working poor families are Idaho and Vermont, the two most rural states in the country. However, many rural states continue to impose income taxes on working families whose incomes fall well below the poverty line.

- Some 18 states levy income taxes on two-parent families of four with incomes *below 75 percent of the poverty line.* Fourteen of these states have a higher proportion of nonmetro residents than the average for the nation as a whole.

It is possible to provide state income tax relief to working poor families without losing substantial amounts of state revenue or jeopardizing state services. If income tax relief is targeted on low income families, its cost is usually modest.

State Earned Income Tax Credits

One increasingly popular way to provide state income tax relief to the working poor is to establish an EITC modeled on the federal credit. Five states now have such credits – Iowa, Maryland, Rhode Island, Vermont, and Wisconsin. In both Vermont (where 77 percent of the population lives in nonmetro areas) and Wisconsin, the state credit is refundable -- making it of even greater assistance for low income working families with children.

The Minimum Wage

A majority of poor workers have earnings at or near the minimum wage. In 1987, when the minimum wage equaled $3.35 an hour, 57.2 percent of poor workers paid by the hour earned $4.35 an hour or less. (The minimum wage would have equalled $4.35 an hour in 1987 if it had maintained its average purchasing power of the 1970s.)

The minimum wage is especially important in rural areas. Nearly one of every three workers paid by the hour in nonmetro areas received wages at or near the minimum wage in 1987. This proportion is far larger than that found among metro workers.

For more than eight years after the minimum wage was raised to $3.35 an hour in January 1981, no further increase was provided. Legislation finally was enacted in November 1989 that will raise the wage floor to $4.25 an hour in April 1991. While this represents a significant increase, the legislation should be considered modest. The wage floor it establishes is far below the historical level of the minimum wage.

- If the level of the minimum wage had simply kept pace with inflation since 1981, it would be an estimated $5.02 an hour in 1991, instead of the $4.25 an hour level established by the new law.

- Throughout the 1960s and 1970s, full-time work at the minimum wage generally lifted a family of three out of poverty.

- By contrast, in 1991, full-time work at the minimum wage will equal just 81.3 percent of the estimated poverty line for a family of three -- and will leave a family of three $2,000 below the poverty line.

To achieve the policy goal of ensuring that full-time work provides a route out of poverty, more of the ground that the minimum wage lost to inflation in the 1980s would need to be made up after 1991. Consideration should be given to restoring the minimum wage to its average value during the 1960s and 1970s. Poverty expert David Ellwood of Harvard University has noted: "Without such a change, it is virtually impossible to guarantee that work will pay enough to keep families out of poverty."

The new legislation also increases the number of businesses -- and therefore the number of workers -- exempt from minimum wage coverage. In addition, the legislation establishes a subminimum wage for many teenagers. Exemptions undermine the income support provided by the wage floor, a result that should be considered in the design of future legislation.

In the absence of a stronger federal minimum wage law, states may wish to raise their minimum wages above the new federal level or provide more comprehensive coverage.

The Combined Strategy: EITC Expansion and Minimum Wage Restoration

If two of the principal reforms discussed in this report -- expansion of the earned income credit and full restoration of the minimum wage – are combined, very substantial progress can be made toward reaching the goal that families with full-time workers should not be poor.

Such a combined approach would be of particular benefit to the nonmetro poor, since the poverty rate among full-time workers is twice as high in nonmetro as in metro areas.

EITC expansion alone would fall well short of assuring that full-time work lifts a family out of poverty. For example, the EITC expansion that passed the House last year would nearly double the maximum benefit provided under the EITC for a family of four with two children, one of whom is less than age six. Nonetheless, the expansion still would leave the family's after-tax income $3,800 short of the projected poverty line in 1991, even if one parent worked full time year round at the $4.25-an-hour minimum wage.

To increase the credit enough to raise a four-person family with a full-time minimum wage worker to the poverty line in 1991 would require nearly *sextupling* the maximum value of the EITC. This would add many billions of dollars in costs.

Minimum wage restoration alone also is not enough. Even if the minimum wage were returned to a level sufficient to lift a family of three with a full-time worker out of poverty, a family of four with a full-time minimum wage worker would be left $2,900 below the four-person poverty line in 1991 (after the benefits of the current EITC are added and payroll taxes are subtracted).

A combination of EITC expansion and full minimum wage restoration is needed to meet the goal that full-time workers and their families should not be poor.

Unemployment Insurance

Since nonmetro workers are more likely than metro workers to be unemployed, and since many poor nonmetro workers experience spells of unemployment during a year, unemployment insurance coverage can be especially important to the well-being of poor nonmetro workers and their families.

Unfortunately, unemployment insurance coverage has dropped sharply in recent years. In 1988, only 31.5 percent of the unemployed nationwide received unemployment insurance benefits in an average month, marking the fifth consecutive year that coverage has set or tied a record low. Prior to this period, the coverage rate fell below 40 percent in only one other year.

In addition, coverage tends to be even lower -- and has fallen more sharply -- in the states with the highest proportion of nonmetro residents.

The deterioration in the unemployment insurance system reflects many factors, including changes in federal and state policies enacted in the 1980s. Policy reforms could play a central role in restoring the strength of the system.

Non-Cash Benefits

Medicaid Coverage

While most *non*-working poor families with children have Medicaid coverage, most of the working poor are ineligible for Medicaid. Many of the working poor also do not receive health insurance coverage through their jobs. As a result, in 1986, nearly half -- or 48 percent -- of poor children living in households in which the head worked full time year round were not covered by any private or public health insurance. Only 18.2 percent of poor children living in a household in which the household head worked full time had Medicaid coverage.

Since 1984, Congress has enacted a series of provisions extending Medicaid coverage to more poor children, including recent legislation extending Medicaid to all children up to age six living in families with incomes up to 133 percent of the poverty line. These provisions, while quite significant, encompass only some of the children of the working poor (that is, young children). To narrow further the health insurance gap for the working poor, more states would need to adopt policy options that allow them to extend Medicaid eligibility to additional poor families with children. At the same time, the federal government could adopt a policy -- which partially wound its way through the legislative process in 1989 -- to extend Medicaid coverage, over time, to all children in poverty.

Extending Medicaid coverage to more poor children would have an especially large effect in nonmetro areas. Most of the poor children now without health insurance coverage are children who live in working families -- and working poor families are disproportionately located in rural areas. Moreover,

some of the most rural states have especially restrictive Medicaid eligibility rules, which deny eligibility to many working poor families.

Food Stamp Outreach to the Working Poor

While approximately 60 percent of all eligible households receive food stamps, only 37 percent of eligible low income *working* households are enrolled in the program. Various studies have found lack of information or misimpressions about eligibility rules to be leading causes for this low participation rate. For example, some families may mistakenly believe that only those receiving AFDC benefits qualify for food stamps.

In July 1989, the federal government began providing matching funds for state outreach programs to provide information on food stamp eligibility rules and how to apply for benefits. In the first five months this option was in effect, nine states moved to take advantage of these federal funds and institute outreach programs. State outreach programs could benefit rural working poor households who currently are eligible for but do not receive food stamps.

Conclusion

The predominant characteristic of the rural non-elderly poor is that they work but still live in poverty. Even though these families play by the rules, their return from work is spartan. A consensus has emerged that policies should be adopted to fulfill work's promise and "make work pay" for these families.

A number of identifiable policies would help achieve the goal of making work pay. These policies are consistent with the philosophical commitment to work our society so often expresses. They could make a significant dent in the extent and severity of poverty among workers and their families -- with the working poor in rural areas among the chief beneficiaries.

I. THE NONMETRO WORKING POOR

Rural areas contain a disproportionately large proportion of working poor families. As a result, policies designed to aid such families should especially benefit these areas.

Indeed, one of the most striking characteristics of rural poverty is the extent to which the rural poor work. Nearly two of every three poor families living in rural areas include at least one worker, and nearly one in four such families have two or more workers. Also, of the 9.1 million poor people dwelling in rural areas in 1987, an estimated 5.8 million lived in a household where at least one member worked.[1] (Poverty data for 1988 on the rural working poor are not yet available. See box for definition of "rural" or "nonmetropolitan.")

Many of the rural poor families that do *not* have any workers are families in which the only adults are elderly or disabled. People who head rural poor families -- and who are not elderly, disabled, or sick -- are likely to work.

- In 1987, some 70.5 percent -- or seven out of 10 -- nonmetro poor family heads who were not ill, disabled, or retired were people who worked during the year.

- An even higher proportion -- 85.6 percent -- of the family heads in poor two-parent families who were not ill, disabled, or retired worked during the year.

- Even among the heads of poor single-parent families in nonmetro areas, more than half -- 53.0 percent -- of those not ill, disabled, or retired worked during the year.

[1] A more extensive examination of the issues covered in this chapter can be found in a report issued by the Center on Budget and Policy Priorities in October 1989, *Laboring for Less: Working but Poor in Rural America.*

Definition of Nonmetropolitan

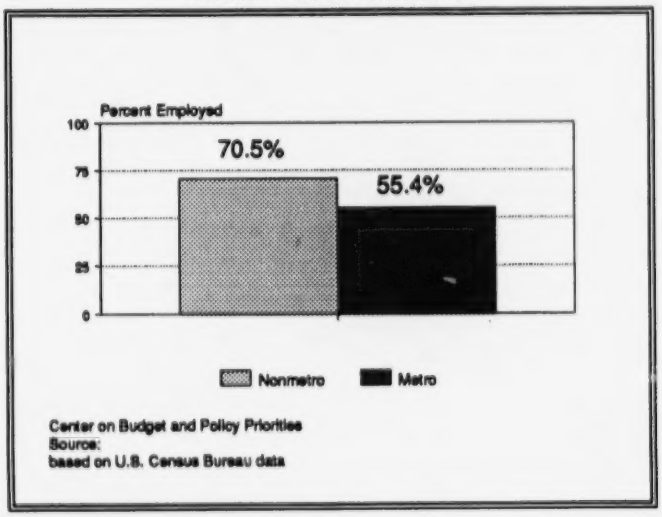
In this analysis, the terms "urban," "metropolitan" and "metro" are used synonymously to describe those areas designated by the Census Bureau as metropolitan statistical areas (MSA). The Census Bureau defines a metropolitan statistical area as "a geographic area consisting of a large population nucleus, together with adjacent communities which have a high degree of economic and social integration with that nucleus. The definitions specify a boundary around each large city so as to include most or all of its suburbs. Entire counties form the MSA building blocks, except in New England where cities and towns are used....An area qualifies for recognition as an MSA if (1) it includes a city of at least 50,000 population, or (2) it includes a Census Bureau-defined urbanized area of at least 50,000 with a total metropolitan population of at least 100,000 (75,000 in New England)." (Bureau of the Census, U.S. Department of Commerce, *Poverty in the United States: 1986*, Series P-60, No. 160, June 1988, p. 151)

The terms "rural," "nonmetropolitan" and "nonmetro" are used to describe those areas that the Census Bureau designates as being outside a metropolitan statistical area.

Thus, most poor families in nonmetro areas are working poor families. Although many of the poor in metropolitan areas also work, the proportion of the poor who work is significantly larger in nonmetro than in metro areas.

- In metro areas, 55.4 percent of the poor family heads in 1987 who were not ill, disabled, or retired were people who worked, compared with 70.5 percent in nonmetro areas (see Figure 1).

Figure 1
Proportion of Poor Household Heads who Worked in 1987 (excluding ill, disabled, or retired household heads)



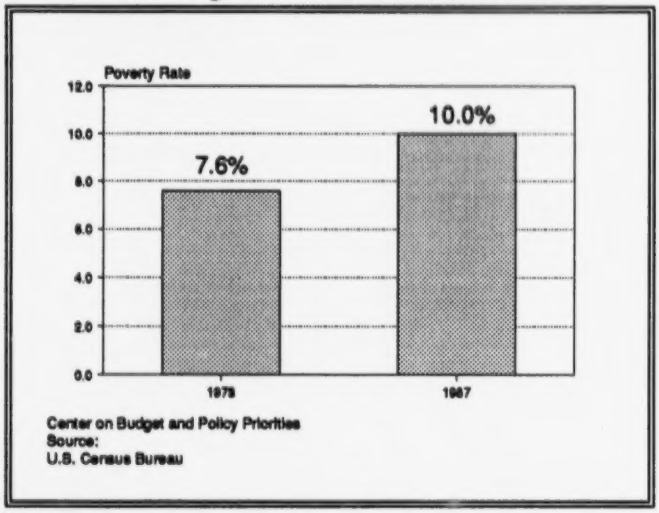
- More than half -- 54.1 percent -- of *all* poor metro families had at least one worker. But, nearly two-thirds -- 64.6 percent -- of poor nonmetro families did.

In addition, the incidence of poverty among nonmetro workers is higher than it was in the late 1970s. Poverty rates among nonmetro workers in 1987 can be appropriately compared with poverty rates in 1978. Both years were advanced stages of economic recoveries, and the national unemployment rate was similar in both years. But in 1987, the poverty rate among nonmetro workers was considerably higher than in 1978 (see Figure 2).

- In 1978, the poverty rate for nonmetro families in which the family head worked was 7.6 percent.

- In 1987, this poverty rate was 10.0 percent, or nearly one-third higher.

Figure 2
Poverty Rate of Nonmetro Families with Working Household Heads, 1978 vs. 1987



Among all types of working families, poverty rates are substantially higher in nonmetro than in metro areas. For both white and black working families -- and for both families headed by a full-time worker and those headed by a part-time worker -- poverty rates are about *twice as high* in nonmetro as in metro areas.

Moreover, new research data show that *long-term* poverty is far more widespread in rural than in urban areas -- and that most long-term poor households in rural areas that are not headed by an elderly or disabled person are working households.

The research, conducted by Greg Duncan and Terry Adams of the University of Michigan, examined the income status from 1976 to 1985 of people who lived in households headed by an able-bodied person under age 65. They found that the proportion of rural people living in such households who

experienced long-term poverty[2] during this period was *77 percent greater* than the proportion of urban people living in such households who experienced long-term poverty.[3]

Duncan and Adams also found that the rural long-term poor households were much more likely to work than the urban long-term poor. In about 40 percent of the rural long-term poor households where the household head was not elderly or disabled, one or more family members worked at least 1,040 hours (i.e., at least half the hours of a full-time year-round worker) in *every one* of the 10 years from 1976 to 1985. In another 25 percent of these households, one or more household members worked this much in at in at least six of the 10 years. By contrast, the proportion of the long-term poor in urban areas who worked this much was considerably lower.[4]

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[2] Greg J. Duncan and Terry K. Adams, "Long-term Poverty in Nonmetropolitan Areas," Survey Research Center, University of Michigan, January 10, 1990.

Duncan and Adams defined the "long-term poor" as people living in households whose total income over a 10 year period was below 125 percent of the sum of the official poverty lines for those 10 years. Their data are drawn from the Panel Study of Income Dynamics.

[3] Their data show that 7.8 percent of the rural population living in households headed by a nonelderly, able-bodied individual experienced long-term poverty from 1976 to 1985. By contrast, some 4.4 percent of the comparable urban population lived in long-term poverty during this period.

[4] The proportion of white rural long-term poor households (other than elderly or disabled households) in which someone worked at least 1040 hours in all or a majority of the 10 years was 38 percent larger than the proportion of white urban long-term poor households in which someone worked this much. Among blacks, the proportion of rural long-term poor households in which someone worked to this degree was more than double the proportion of long-term poor households in urban areas with this amount of employment.

II. THE STRATEGY: MAKE WORK PAY

A strategy can be devised that consists of measures -- outside the welfare system -- to "make work pay"[5] and thereby assist the nonmetro working poor and other low income working families. The objective would be to fashion a coordinated series of reforms designed to achieve a fundamental goal: *if a parent works full time, the parent and the children in the family should not have to live in poverty.*

The goal is consistent with the American dream: that work should pay off and be a path to upward mobility.

As the data in the previous chapter indicate, policies to "make work pay" would disproportionately benefit nonmetro areas. Since a larger fraction of the nonmetro poor than of the metro poor are employed, such policies would raise the incomes of a larger fraction of the poverty population in nonmetro areas.

The disproportionate benefit to rural areas from such policies can be see in another comparison as well. In 1987, some 23 percent of the *overall* U.S. population lived in nonmetro areas -- but the authors estimate that 33 percent of the *working poor* population lived in such areas.

In addition to providing essential income support to the working poor, the strategy could encourage work, bringing more people into the labor market and making work relatively more attractive compared with public assistance. (This point should not be misconstrued. The benefits from working can indeed be less, or only minimally more, than the benefits from government assistance. However,

[5] For an excellent discussion of the "make work pay" strategy, see David Ellwood, *Poor Support: Poverty in the American Family*, Basic Books, 1988.

this is because the rewards from working can be small, not because government assistance is especially generous. In fact, the support provided to low income families by government programs has diminished sharply in recent years and, in most cases, leaves recipients well below the poverty line.[6])

In short, the best way to promote work is to ensure that it provides an adequate standard of living.

In addition to reducing nonmetro poverty rates substantially, measures to "make work pay" may provide a modest but significant boost for nonmetro economies. Since the working poor constitute a considerable proportion of the population in many nonmetro areas, raising their incomes may boost their demand for products and thus stimulate local economic growth. In the many nonmetro counties with widespread poverty, the ripple effect from the boost in incomes could be especially significant.

Because making full-time work provide an escape from poverty is consistent with the basic values of this country, the goal should be acceptable across the political spectrum. In the past two years, it has been espoused by a growing number of liberals and conservatives alike.

Significant differences remain, of course, over the best set of policies to achieve the goal. In some areas, however, the outlines of a policy consensus are beginning to take shape. One area where a consensus appears to be emerging is tax policy toward the working poor. Federal and state tax policies are the subjects of the next two chapters.

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[6] For example, in six of the 10 most rural states, AFDC benefits for a family of four without other income declined by more than 23 percent from 1979 to 1989, after adjusting for inflation. In the typical (or median) state of these 10 states, AFDC benefits provided to a family of four without other income equaled less than two-fifths of the poverty line in 1989.

III. FEDERAL TAX POLICIES

Tax policies directly influence how much work pays. Some taxes reduce the net income of working poor households by significant amounts. At the same time, "refundable" tax credits -- in which some taxpayers receive checks back from the government -- can increase the income of working poor households.

The federal Earned Income Tax Credit, a refundable tax credit for low income working families with children, is a significant source of support for the working poor. A number of proposals pending in Congress would expand the credit and provide more assistance to working poor families.

Other proposals before Congress would restructure the Dependent Care Tax Credit so that it assists working poor families with child care costs. Under its current structure, the credit provides virtually no assistance to these families.

This chapter analyzes policy options to alter federal tax policies in ways that would benefit the nonmetro working poor.

The Earned Income Tax Credit

The federal earned income tax credit -- or EITC -- is for low income families that have earnings and at least one child living at home. The credit applies to families with earnings up to $19,340 in 1989. The maximum benefit for tax year 1989 is $910.

A key feature of the credit is its "refundability." This means that if the credit for which a family qualifies exceeds the family's income tax liability, the family receives a check from the Internal Revenue Service for the difference. For

example, if a family has income too low to owe federal income tax but qualifies for a $600 EITC, the IRS will send the family a check for $600. The refundable aspect of the credit initially was designed to help offset the high burden of regressive payroll taxes -- that is, Social Security and Medicare taxes withheld from paychecks -- that low income working families must pay even if they owe no income tax.

The credit is widely regarded as strongly "pro-family." It is extended only to families in which parents live with and support children. Fathers who have left their families and do not live with children do not qualify. The credit also does not discriminate against two-parent families -- two-parent and single-parent families receive the same benefit if they have the same earnings.

In key respects, the credit also is "pro-work." Adults who do not work do not qualify. Moreover, while welfare benefits fall quite dramatically as earnings rise -- thereby decreasing the returns from working for the very poor -- the EITC rises with earnings for the very poor. As a result, the EITC provides a work incentive for very poor families.

Congress established the credit in 1975 and enlarged it substantially as part of the Tax Reform Act of 1986. It is now emerging as one of the federal government's major sources of support for low income families that work. For tax year 1989, nearly 11 million families are expected to receive benefits totalling $5.8 billion.

Most families receiving the EITC have a full-time worker. A recent Congressional Research Service analysis found that in nearly 60 percent of families eligible for the EITC, either the family head or spouse worked full time (defined by the CRS analysis as at least 1,750 hours per year, or 35 hours per week for 50 weeks).[7]

For tax year 1989, a family receives a 14-cent credit for each dollar earned up to $6,500. At that earnings level, a family qualifies for the $910 maximum credit. The credit remains $910 until earnings surpass $10,240. The benefit then phases out at a slow pace, declining just 10 cents for each additional dollar earned, until it falls to zero at an income of $19,340. Most working families that have children and earned between $5,000 and $12,000 in 1989 qualify for a credit of at least $700 (see Figure 3).

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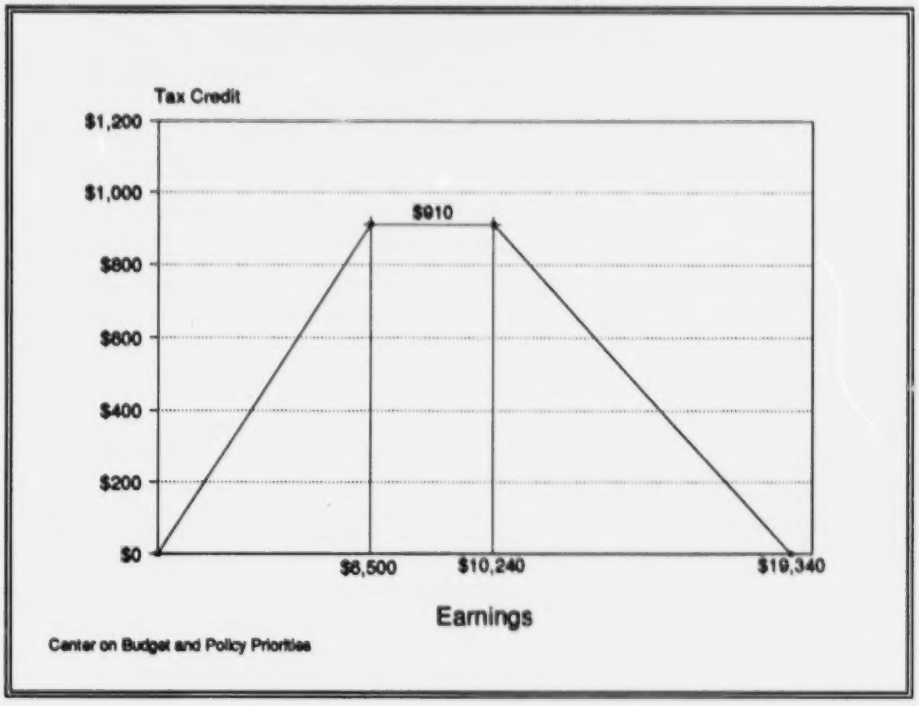
[7] Thomas Gabe, "Distributional Effects of Selected Proposals to Modify the Earned Income Tax Credit," Congressional Research Service 89-553, September 28, 1989, p. 9.

Figure 3
Earned Income Tax Credit, 1989



Because the EITC provides substantial income assistance to the poor while promoting the values of family and work, it enjoys support across the political spectrum. In recent years, the idea of expanding the EITC has gained an impressive number of conservative and liberal adherents. The virtues of such an expansion have been extolled by the Task Force on Families convened by President Reagan during his tenure, leading Republican and Democratic members of Congress, respected poverty analysts such as David Ellwood of Harvard University and Robert Reischauer (while at the Brookings Institution[8]), and organizations as disparate as the Children's Defense Fund, which generally favors increased federal aid to the poor, and the Heritage Foundation, which generally favors reduced federal aid to the poor.

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[8] Robert Reischauer is now the director of the Congressional Budget Office.

Applicability to the Nonmetro Working Poor

Expansion of the EITC is a policy reform admirably suited to the needs of the nonmetro poor. A substantial majority of nonmetro poor families -- 64.7 percent in 1987 -- have earnings and potentially would benefit. In fact, the nonmetro poor would be *overrepresented* among the expanded EITC's beneficiaries -- since a lower proportion (54.3 percent) of metro poor families have earnings.

In addition, the way assistance is provided under the EITC is particularly suitable to the needs of the nonmetro working poor. Applying for the EITC -- through filing an income tax return -- is a private act, precluding the possibility of public stigma. Also, the application and receipt of benefits does not require travel; getting to government offices can be a problem for the nonmetro poor under other government programs.

Finally, the program does not require rural states with limited fiscal capacities to commit more resources to the poor. (To the contrary, the EITC results in an infusion of federal funds into a state.) For reasons both of philosophy and financial ability, predominately rural states tend to be less generous than more urban states in providing government assistance to poor families.

EITC Well-suited to Nonmetro Working Poor

1. Nonmetro working poor overrepresented among EITC beneficiaries.
2. No stigma attached to receiving EITC benefits.
3. No geographic accessibility problems to receiving benefits.
4. Does not require additional state funds from poor rural states.

EITC Reform Proposals

In both nonmetro and metro areas, working poor families with several children face a difficult situation today. Family needs increase as family size grows. Recognizing this, the national poverty line rises with family size. Welfare benefits also increase with family size. But wages do not.

Since the same wages do not go as far for a large family as for a small one, it is not surprising that working families with several children are more likely to be poor than smaller families. Large families that are poor also are likely to fall further below the poverty line than smaller poor families. In addition, as family size increases, low-paid work becomes increasingly less competitive with public assistance.

What consequently is needed is a wage supplement for working poor families that is geared to family size. The EITC currently does not provide different levels of benefits to families with different numbers of children, but it could be easily adapted to serve this purpose.

Such a reform -- increasing EITC benefits as the number of children in a family increases -- now is attracting growing support among poverty analysts and policy-makers alike. A number of proposals along these lines were introduced in Congress in 1989.

Among the most prominent are a proposal by Representative Thomas Downey (a Democrat) and one advanced by Rep. Thomas Petri (a Republican). Both call for large EITC expansions, costing $5 billion to $7 billion annually.

The Downey proposal is known as the Employment Incentives Act and is co-sponsored by Reps. George Miller and John Lewis, and others. Senator Albert Gore has introduced companion legislation in the Senate. The Downey proposal would substantially expand the maximum credit for families with one child and more than the double the credit for families with two or more children.[9]

The Petri proposal, known as the Family Living Wage Act, would vary benefits both by family size and by the age of the children. The largest benefit increases would be for families with children under age six.[10]

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[9] The maximum credit would be raised from $910 in 1989 for all family sizes to $1,365 for a family with one child and to $1,950 for a family with two or more children. The new credit would equal 21 percent of the first $6,500 in earnings for a family with one child and 30 percent of the first $6,500 in earnings for a family with two or more children. These figures are all in 1989 dollars.

[10] Under the Petri bill, the credit would be increased by up to $640 for each pre-school child (age 0 to 5) and up to $320 for each school-age child (age 6 to 15), up to a maximum of four children. A family with one pre-school child and one school-age child would receive a credit of 30 percent of its first $6,377 in earnings for a maximum credit of $1,913. (These figures are in 1989 dollars.) The bill phases in benefits over essentially the same range as under current law, but benefits would begin to be reduced sooner than under current law.

(continued...)

A third proposal, passed by the House of Representatives with bipartisan support in September 1989, combines elements of both the Downey and Petri proposals. It would raise the EITC as the number of children in a family rises, up to a maximum of three children -- and then would provide a further increase if any of the family's children are under age six.[11] Although somewhat smaller than the Downey or Petri expansions, the House-passed expansion would be quite significant. For example, the credit would nearly double (compared with current law) for families with two children, one of whom is less than age six. The Senate also passed an expansion in the EITC, but its expansion was very limited: it would increase EITC benefits only for families with children under age four.

With most nonmetro poor families having at least one worker, the House EITC expansion -- if it were to become law -- would be of disproportionately large benefit to the nonmetro poor.

Other Aspects of EITC Reform

In addition to expanding the credit, other steps could be taken to improve its effectiveness for the nonmetro working poor. One such step would be to insure that low income working families with children are aware of the credit and of the need to file a federal income tax return to receive it.

Paradoxically, the other low income tax relief provisions of the Tax Reform Act of 1986 may cause some working poor families to fail to apply for EITC benefits they have received in the past. Under the Tax Reform Act, most working poor families no longer owe federal income tax; overall, some 5 million to 6 million low income households were removed from federal income tax rolls. As a result, many of these households now receive W-2 forms from their employers

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[10] (...continued)

The Petri bill contains another significant feature: it *repeals* the dependent care tax credit and applies the revenue saved as a result toward the cost of the EITC expansion.

[11] The proposal would raise the base credit from 14 percent to 17 percent for a family with one child, to 21 percent for a family with two children, and to 25 percent for a family with three or more children. The dollar amount of the maximum base credit would be raised from its 1989 level of $910 for all family sizes to $1,105 for a family with one child, to $1,365 for as family with two children, and to $1,625 for a family with three or more children (these figures are in 1989 dollars). An additional increase in the credit of six percent -- or a maximum of $390 -- would be provided if any of the family's children are under the age of six.

This proposal was adopted as part of the House reconciliation bill, but was not incorporated into the reconciliation bill ultimately enacted into law.

showing no federal income tax withheld during the previous year. Many working poor families may fail to file an income tax return as a result. Yet if they do not file, they lose the EITC benefit they may have earned.

If the EITC is to encourage work and reduce poverty, working families too poor to owe income tax must know of its existence and the need to file a federal tax return to receive it.[12]

Some significant EITC outreach efforts were launched in 1989. These efforts involved public officials (including governors, mayors, and directors of welfare programs) and non-governmental groups (including business, labor, religious, and charitable organizations). However, the activity was largely concentrated in metropolitan areas, and especially in cities. More extensive outreach efforts are needed in nonmetropolitan areas as well.[13]

Measures also should be taken to make it easier for working families to receive the credit payments in their regular paychecks. The Internal Revenue Code has long required that workers receive EITC payments throughout the year in their regular paychecks, if they make this request to their employers and complete an appropriate withholding form that employers should have in stock (the W-5 form). Employers subtract the EITC payments from the income and payroll taxes they would otherwise pay to the IRS.

For many families, the EITC is likely to be more effective -- both in helping to meet living expenses and in increasing the attractiveness of work -- if it is reflected in a worker's regular paycheck. Unfortunately, few workers or employers appear to be aware of this option. More than 99 percent of those receiving the credit now obtain it as a lump sum (in the form of a tax refund)

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[12] One technical but significant reform to the EITC occurred on October 1, 1989. Prior to that date, a family's EITC benefits were counted as income when the family's eligibility and benefit levels for certain programs were determined. As a result, the receipt of an EITC check could result in the family's AFDC benefits being reduced -- or even in the family being removed from AFDC and Medicaid for several months because the EITC payment would lift the family over income eligibility limits.

Effective October 1, 1989, however, EITC benefits are no longer counted as income when eligibility or benefit levels for these programs are determined. This change in policy, mandated by the 1988 welfare reform legislation, should facilitate EITC outreach efforts -- since the risk of losing other benefits now has been greatly reduced. EITC benefits also are not counted as income when food stamp eligibility and benefit levels are determined.

[13] The Center on Budget and Policy Priorities initiated and helped coordinate the 1989 campaign to publicize the credit and the need for low income working families to file a federal income tax return. The campaign has involved governors, mayors, business and labor groups, religious and charitable organizations, and others. The Center plans to add a rural component to the campaign in 1990. Efforts are needed on a much larger scale, however.

after the end of the year. An objective of EITC outreach efforts should be to inform potential recipients that the credit can be received in regular paychecks.

A second approach to increasing the receipt of the credit in regular paychecks is in the Downey proposal and the House-passed bill. These proposals would require employers to collect a form from all new employees indicating whether the employee desires -- and is eligible -- to receive EITC payments in his or her paycheck. This would inform new employees about the credit and the possibility of receiving regular payments in their paychecks.

The Dependent Care Tax Credit

Another key policy change that could assist low income working families in both nonmetro and metro areas would be to reform the dependent care tax credit so that working poor families could take advantage of it.

The dependent care tax credit is a tax subsidy reducing the child care costs of working families. The size of the credit depends upon a family's income, the number of dependents in child care, and the size of the family's child care costs.

If a family has one dependent who is under age 13 or is mentally or physically incapacitated -- and who needs child or dependent care to free a family member to work -- the family receives an income tax credit for a portion of its child care or dependent care costs. The maximum credit allowed is 30 percent of the first $2,400 in expenses, for a credit of $720. If a family has two or more children or other dependents in care, the maximum credit is 30 percent of the first $4,800 in expenses, or $1,440. Credit amounts are lower for families with incomes over $10,000.

Some 8.2 million households claimed the credit in 1988, with total credits amounting to an estimated $3.4 billion.

Yet the credit fails to assist the very group that needs child care assistance the most -- working poor families -- because it is *not* refundable. Those too poor to owe income tax receive no credit payment. By contrast, families at higher income levels do receive the credit (it lowers their income tax liability) and through it, a federal child care subsidy.

As a result, nearly all of the child care subsidy provided by the credit, which is now the federal government's principal source of child care assistance, goes to middle and upper income families. In 1986, only five percent of the

assistance provided under the credit went to families with adjusted gross incomes of less than $10,000.

Moreover, the proportion of the assistance provided to low income families has dropped even further since then. Since poor families no longer owe federal income tax as a result of the Tax Reform Act of 1986, the child care credit is now of no use to them. In fact, an Urban Institute analysis estimated that *only three percent of all assistance provided through the dependent care credit goes to families in the bottom 30 percent of the income distribution.*[14]

An obvious remedy is to make the dependent care tax credit refundable, so that low income families whose credit exceeds their income tax liability can receive the difference in a check from the government. This proposal has been endorsed by President Bush and a number of members of Congress.

Under current law a family of three that has an income of $10,000 and incurs $2,000 a year in child care expenses would not owe any federal income tax -- and thus would receive no benefit from the dependent care credit. If the credit were made refundable, such a family would receive a check for $600 to help defray its child care costs. The credit would equal 30 percent of the family's costs.

Example: Family of three with income of $10,000 and dependent care expenses of $2,000.

	Credit Assistance
Under current law	$0
If credit made refundable	+$600

Making the dependent care tax credit refundable would provide support to many poor nonmetro working poor families. Like an expansion of the EITC, this policy reform would not be stigmatizing and would not require trips to distant welfare offices.

Proposals to make the credit refundable are making progress in Congress. In 1989, the Senate passed legislation that would make the dependent care credit

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[14] Roberta Ott Barnes, "The Distributional Effects of Alternative Child Care Proposals," The Urban Institute, October 28, 1988, p. 4.

90 percent refundable. A family would receive a check for 90 percent of the amount by which its dependent care tax credit exceeded its income tax liability.

Making the dependent care credit refundable is a basic part of an income-related strategy to "make work pay." If a low income working family incurs substantial child care costs, its disposable income may fall far below the poverty line even if its gross earnings appear to lift it out of poverty. Moreover, for many families faced with the prospect of a low wage job, the costs of child care can diminish or even negate the advantages of working outside the home. Helping to defray some of these costs is needed to raise full-time working families out of poverty.[15]

It should be noted, however, that enabling working poor families to offset some of their child care costs through use of a refundable tax credit addresses only one aspect of these families' child care needs. A tax credit does not directly affect the range or quality of services provided, or enable a poor family to locate reputable child care services it can afford. Measures to improve the quality of child care services and expand child care referral networks are also needed -- and are reflected in other pieces of legislation now before the Congress (such as the Act for Better Child Care bill). In keeping with this paper's focus on income strategies, these issues and proposals are not addressed here, but that is not intended to minimize their importance.

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[15] Another reform in the dependent care credit that would aid the nonmetro working poor is raising the percentage of dependent care costs of low income families that are covered by the credit. The maximum credit equals 30 percent of eligible expenses; if this percentage were raised for low income families, a greater proportion of child care costs would be offset, further alleviating income problems and encouraging work. Senators Bob Packwood, a Republican, and Daniel Patrick Moynihan, a Democrat, are among those who have proposed raising the credit percentage for low income families along with making the credit refundable.

IV. STATE TAX POLICIES

The Tax Reform Act of 1986 removed working poor families from the federal income tax rolls. This action was based in the recognition that imposing income taxes on those who work but remain poor pushes such families deeper into poverty.

In the three years since the passage of the Tax Reform Act, a number of states have followed the federal lead and removed working poor families from their income tax rolls. Two-fifths of the states with state income taxes now exempt families of four with income at or below the poverty line from income tax liabilities.

In the other three-fifths of the states with an income tax, many working poor families continue to be taxed. Moreover, in some of these states, working families with earnings as low as *one-third of the poverty line* must pay income tax.

Whether a state subjects its working poor families to income tax is particularly relevant in nonmetro areas. Since rural poor families are more likely to have earnings than their urban counterparts, state income taxes on working poor families are likely to hit a larger proportion of the rural poor.

Policy reforms to remove working poor families from state income tax rolls are another component of the "make work pay" strategy – as well as another policy initiative that disproportionately benefits the rural poor.

State Income Taxes

Forty states have income taxes.[16] In 1989, some 16 of these states did not impose income taxes on families of four with incomes at or below the poverty line. The other 24 states continue to levy taxes on working poor families.

In the years following the passage of federal tax reform in 1986, approximately 29 states removed some or all working poor families from state income tax rolls.

The states that continue to impose burdensome income taxes on working poor families include several that raised their income tax thresholds but still tax significant numbers of low income residents. Others failed to raise their income tax thresholds at all. Among the states that continue to impose income taxes on their working poor residents are a substantial number of rural states. (Appendix I lists all the states and their proportion and number of rural residents.)

- In 1989, some 18 states levied income tax on two-parent families of four with incomes below 75 percent of the poverty line. (The projected poverty line for a family of four in 1989 is $12,721; three-quarters of the poverty line is $9,540.)

- Fourteen of these 18 states have a higher-than-average proportion of nonmetro residents. These 14 states are listed in Table I. (Of all 50 states, 33 have a higher-than-average proportion of nonmetro residents. That two-thirds of the states have higher-than-average proportions of nonmetro residents occurs because in many of the most populous states, the residents are heavily concentrated in metro areas.)

- Seven states impose income tax on two-parent families of four with incomes below *half* the poverty line. Five of these states have a higher-than-average proportion of their residents living in nonmetro areas. These five states are Alabama, Arkansas, Indiana, Kentucky, and Virginia.

- The state that imposes the most severe income tax burdens on its working poor households is Kentucky. In that state, a family of four

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[16] The District of Columbia also has an income tax. The D.C. income tax is not imposed on families of four with incomes below the poverty line.

with earnings of $10,000 owes $281 in state income tax. Kentucky is the 13th most rural state in the nation.

Table I
State Income Taxes on Poor Families of Four
in Selected Rural States*

State**	Income Tax Thresholds, 1989 (for two-parent families of four)	Tax at $10,000 of Income, 1989
Indiana	$4,000	$204
Kentucky	4,300	281
Alabama	4,500	158
Arkansas	5,600	130
Virginia	5,900	93
Montana	6,500	109
Iowa	8,000	100
West Virginia	8,000	60
Missouri	8,200	55
Arizona	8,400	32
Delaware	8,600	45
Georgia	9,000	10
Oklahoma	9,200	33
Oregon	9,300	50

*Table includes all states that impose income taxes on two-parent families of four with income below 75 percent of the poverty line and that have a higher-than-average proportion of nonmetro residents.

**Hawaii, with an income tax threshold below 75 percent of the poverty line in 1989, was excluded from this list because it has income tax credits that normally raise the income tax threshold above the poverty line.

Although a number of states with higher-than-average rural populations impose significant income tax burdens on their working poor households, others do not. Among the rural states with income taxes that do not levy any income taxes on working poor families are Idaho and Vermont, the two most rural states in the country. The other rural states that do not levy income tax on working poor families are: Hawaii, Kansas, Maine, Minnesota, Mississippi, Nebraska, North Carolina, North Dakota, South Carolina, and Wisconsin. In the rural states of

Louisiana and New Mexico, the state begins to tax families whose incomes are just below the poverty line.

Relieving State Income Tax Burdens

In the states that continue to impose income tax burdens on working poor families, reducing or eliminating their burdens would represent sound policy and be of particular benefit to the nonmetro poor. In most areas, it should be possible to provide such tax relief without losing substantial amounts of state revenue or jeopardizing state services.

The potential for relieving the income tax burdens of the working poor without losing much revenue stems from a fundamental point: if state income tax relief is well targeted, it usually has only a modest cost. The key is to focus the relief on lower income families, rather than on all families.

This can be accomplished by any of several approaches.[17] One is simply to establish a "no-tax floor" – an income level below which no income tax is owed. A number of states now have no-tax floors. Some states set these floors at the same level as the federal income tax thresholds.

A second approach is to raise the state's standard deduction. Since more affluent taxpayers generally itemize deductions, increases in the standard deduction primarily help low and moderate income taxpayers.

State Earned Income Tax Credits

Still another promising approach is to establish a state earned income tax credit, modeled on the federal credit. Five states now have such credits -- Iowa, Maryland, Rhode Island, Vermont, and Wisconsin. In each state, the earned income credit equals a specified percentage of the federal EITC.

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[17] For a detailed discussion of options for providing low income tax relief at the state level, see Robert Greenstein and Frederick Hutchinson, "State Tax Relief for Low Income People," in *The Unfinished Agenda for State Tax Reform*, edited by Steven D. Gold (National Conference of State Legislatures, November 1988). Much of the discussion here is drawn from that article. For comprehensive discussions of all state taxes and the poor, see Steven D. Gold, *State Tax Relief and the Poor*, National Conference of State Legislatures, April 1987, and David Kahan with Robert Greenstein, *The Next Frontier: Relieving State Tax Burdens on the Poor*, Center on Budget and Policy Priorities, April 1987.

In Maryland, the credit eliminates any state income tax liability for working poor families that have four or fewer people. In Iowa, the credit raises the state income tax threshold for families of four by $500.

In Vermont, the second most rural state in the nation, and in Wisconsin, the state earned income credit is *refundable* – so that it also serves as a wage supplement for low income working families with children. In both of these states, two-parent families of four with earnings of $10,000 receive a $228 refund from their state. In Wisconsin, the credit also is adjusted by the number of children in a family.

The Vermont refundable EITC was enacted in 1988, while the Wisconsin credit passed in 1989. In Wisconsin, support for a refundable state EITC came from across the political spectrum, with a coalition of conservative and liberal legislators leading the effort. The same broad political appeal that the federal EITC now enjoys in Congress and at the White House was manifested at the state level in Wisconsin.

Enactment of refundable credits in these states suggests this may be a fruitful policy area to pursue in other states as well. Few state policy initiatives are likely to be as beneficial for rural working poor families as state earned income credits.

State Dependent Care Tax Provisions

Still another feature of state tax codes that is especially relevant to working poor families is the treatment in the codes of child care costs. Some states provide income tax credits or deductions for child care or other dependent care costs that enable a family member to work, while other states do not. Moreover, in some states, these provisions assist low income working families with children, while in a majority of the states, these provisions are of little or no benefit to the working poor.

A survey by the National Women's Law Center completed at the end of 1987 found that 25 of the 41 states with state income taxes provide some form of dependent care tax relief. One state without an income tax, Alaska, also provides dependent care relief. In 18 of these 26 states, dependent care tax relief is provided through a tax credit, while in the other eight states it is provided in the

form of a tax deduction. In 21 of the 26 states, the state credits or deductions are tied to the federal dependent care tax credit.[18]

Just as the federal dependent care tax credit is of limited use to working poor families -- because they typically owe no federal income taxes and the credit is not refundable -- so also are many of the state dependent care tax provisions of little use to working poor families. In some states, the amount of the state credit is simply a fixed percentage of the family's federal credit. If the family receives no federal credit because the federal credit is not refundable, it might not receive a state credit either. In addition, most of the state credits are, themselves, *non*refundable -- so that families owing no state income tax derive no benefit from them. Furthermore, in states with dependent care *deductions*, the deduction has no value to families too poor to owe state income tax.

Finally, even where low income working families can qualify for a credit or refund and do owe state income tax, the value of the credit is likely to be rather small (unless it is refundable) -- because the state income taxes that the family would owe, and against which the credit would be applied, are usually relatively modest. Hence, even in the states in which a working poor family can benefit from a state dependent care credit or deduction, the benefit is likely to defray only a very small fraction of the family's child care expenditures.

There are a few states, however, where dependent care tax provisions are of greater significance to the working poor. The National Women's Law Center survey found that three states -- Alaska, Minnesota, and New Mexico -- have made their dependent care tax credits refundable, so they may provide benefits to working poor families that owe no state income taxes.[19] In Minnesota, the maximum refundable credit is $720 per dependent -- a sizable amount of assistance. A maximum of two dependents can be claimed under this provision.

All three of these states have large rural populations. The majority of both Alaska's and New Mexico's populations live in rural areas, while one-third of Minnesota's population lives in rural areas.

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[18] Lynne Crofton Isensee and Nancy Duff Campbell, *Dependent Care Tax Provisions in the States: An Opportunity for Reform*, National Women's Law Center, 1987. This publication includes an extensive discussion of options for improving state tax provisions dealing with dependent care costs.

Since 1987, two states -- Georgia and New York -- have repealed their dependent care tax provisions. They are not included in the list of 26 states.

[19] Alaska does not have a state income tax, but families may file a claim for a refund from the state based on the family's dependent care expenses.

To provide more child care assistance to working poor families, states that have dependent care tax provisions could take steps such as making dependent care credits refundable and replacing dependent care deductions with refundable credits. These steps would ensure that these provisions assist low income working families with children, rather than only higher income families. States without dependent care tax provisions could choose to enact such provisions and to design these provisions so that they provide support to working poor families.

V. THE MINIMUM WAGE

Reforms in tax policies can increase the income of the nonmetro working poor significantly. By themselves, however, these reforms cannot provide enough income support to achieve the goal of ensuring that full-time work lifts a family out of poverty. To achieve this goal, tax policies must work in tandem with wage policies. The value of the minimum wage is particularly important.

After the minimum wage was raised to $3.35 an hour in January 1981, no further increase was provided for more than eight years. During this period, the Consumer Price Index -- the nation's measure of inflation -- rose more than 40 percent. As a result, the purchasing power of the minimum wage eroded substantially, pushing a number of low wage workers into poverty.

The level of the minimum wage is especially significant to the rural working poor. A large fraction of the nonmetro workforce is employed at or near the minimum wage.

In November 1989, legislation was enacted to raise the minimum wage to $3.80 an hour in April 1990 and $4.25 an hour in April 1991. However, this legislation makes up only part -- about two-fifths -- of the ground lost to inflation during the 1980s. The minimum wage will remain far below its level in earlier decades and will enable a smaller proportion of low wage workers to escape from poverty.

To achieve the goal that full-time work should assure a way out of poverty, the minimum wage would need to be restored to its level in the 1960s and 1970s.

Background

As a result of the failure to raise the minimum wage for such a long period, its value in 1989 was well below its level in earlier years. In fact, the purchasing power was at its lowest level in four decades.

- After adjusting for inflation, the purchasing power of the minimum wage in 1989 was at its lowest level since 1949.

- Throughout the 1960s and 1970s, full-time work at the minimum wage generally lifted a family of three out of poverty. During these two decades, minimum wage earnings averaged slightly above -- 103.6 percent of -- the poverty line for a family of three.

- By contrast, in 1989, a person working full time at the minimum wage earned approximately $3,000 -- or 30 percent -- less than the poverty line for a family of three. Full-time annual minimum wage earnings equaled $6,968, compared with a projected poverty line for a family of three of $9,926.

While most minimum wage workers are not poor, a majority of the poor who work do have earnings at or near the minimum wage level.[20] Congressional Budget Office data indicate that in 1987, nearly three of every five poor workers paid by the hour -- 57.2 percent -- earned $4.35 an hour or less (see Figure 4). Raising the minimum wage would have significant effects on many of these workers.[21]

Moreover, the decline in the purchasing power of the minimum wage has aggravated the income problems of the nonmetro working poor substantially. In 1987, more than two of every five nonmetro workers received wages so low that these wages could not lift a family of four to the poverty line even if the worker in the family was employed full time year round.[22]

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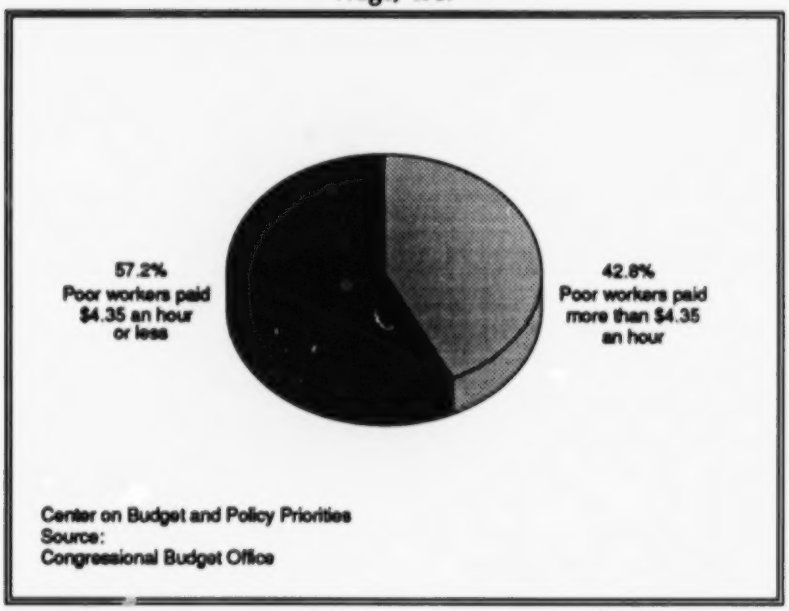
[20] Most minimum wage workers do not fit the stereotype of teenagers in their first job. In 1988, half -- 50.3 percent -- of those hourly and salaried workers earning the minimum wage or less were 25 years or older, while another 20.6 percent were 20-24 years old. Only 29.2 percent of minimum wage workers were teenagers.

[21] Data for *nonmetro* workers only are not available.

[22] Lucy Gorham and Bennett Harrison, Massachusetts Institute of Technology, "Working Below the Poverty Line: The Growing Problem of Low Earnings Across the United States," prepared for the Ford Foundation and the Rural Economic Policy Program, draft, June 1989.

Figure 4
Proportion of Workers Paid by the Hour Earning Wages At or Near the Minimum Wage, 1987


57.2%
Poor workers paid $4.35 an hour or less
42.8%
Poor workers paid more than $4.35 an hour
Center on Budget and Policy Priorities
Source:
Congressional Budget Office

- In 1979, some 31.9 percent of nonmetro workers earned a wage too low to lift a family of four out of poverty even with full-time year-round work.

- By 1987, however, this proportion had grown to 42.1 percent.

In addition, nearly one in three nonmetro workers paid by the hour received wages at or near the minimum wage in 1987,[23] a proportion far larger than among metro workers (see Table II).

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[23] Susan E. Hendrickson and Isabel V. Sawhill, "Assisting the Working Poor," Changing Domestic Priorities Discussion Paper, The Urban Institute, May 1989, Table 7.

- In 1987, some 11.8 percent of nonmetro workers paid by the hour earned the minimum wage or less. In metro areas, the corresponding figure was 7.2 percent.

- Some 32.2 percent of nonmetro workers paid by the hour -- nearly one in every three -- earned less than $4.35 an hour. By contrast, 21.6 percent of the metro workers paid by the hour earned wages in this range.

Table II
Nonmetro Workers Paid by the Hour More Likely to Earn Near Minimum Wage

	Earned less than or equal to minimum wage in 1987	Earned less than $4.35 an hour in 1987
Nonmetro workers	11.8%	32.2%
Metro workers	7.2	21.6

The $4.35 cutoff is significant because, if the minimum wage had kept pace fully with inflation – and had continued to meet the historic standard of providing a full-time worker enough income to lift a family of three out of poverty – it would have been $4.35 an hour in 1987.

Policy Reforms

In the past few years, minimum wage legislation has been hotly contested. Congress passed a measure to raise the minimum wage in the spring of 1989, but President Bush vetoed it. Then, in the fall of 1989, Congress and the President agreed on a smaller minimum wage increase than that vetoed by President Bush a few months earlier.

The legislation enacted in November will raise the wage floor to $4.25 an hour in April 1991. While this represents a significant increase over the previous floor of $3.35 an hour, the legislation should be considered modest. Its wage floor is far below the historical level of the minimum wage. In addition, the legislation substantially increases the number of businesses – and therefore the number of workers – exempt from minimum wage coverage and establishes a subminimum wage applicable to many teenagers (see box).

Minimum Wage Coverage

In addition to setting the level of the minimum wage, Congress decides minimum wage *coverage* -- that is, which workers are covered by the minimum wage. In 1988, some 11 million nonsupervisory employees were exempt from minimum wage coverage, and 2.8 million workers had earnings *below* the minimum wage level (some of those with earnings below the minimum wage were employees covered by the minimum wage law but underpaid by their employer). Of particular concern to the nonmetro working poor, nearly three of every five wage and salaried workers employed in agriculture are exempt from minimum wage coverage.

In contrast to minimum wage legislation of previous years, which typically expanded the number of employees covered, the legislation enacted in November 1989 expands the number of *exempt* employees. For example, it greatly expands the number of small businesses whose employees are not covered.

Another significant coverage issue is the establishment of a "training wage," largely at the insistence of the Bush administration. The new legislation provides for a subminimum wage equal to 85 percent of the minimum wage -- or $3.61 an hour in 1991 -- for certain teenage workers. This subminimum wage can be paid to teenagers for as many as 180 work days.

During the first 90 days of employment at the subminimum wage, there is no requirement that on-the-job training is provided. However, for an employee to be paid 90 more days at the subminimum wage, the employee must be working for an employer who has established an on-the-job training program meeting criteria to be established by the Department of Labor.

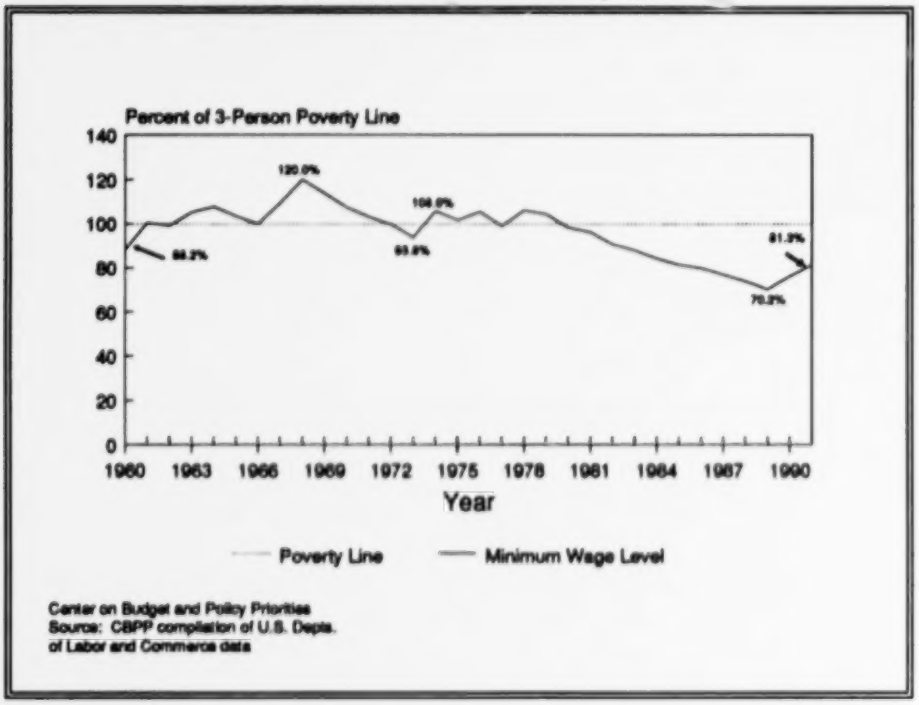
The length of this subminimum wage has been criticized. Available data indicate that the following types of jobs require a maximum of 30 days of training: assembler, custodian, food service worker, laundry workers, and laborer. These jobs often pay at or near the minimum wage.

The training wage provision is scheduled to expire in April 1993. During this period, Congress has the opportunity to assess how this approach works, including whether it is a necessary inducement for employers to hire teenagers, whether it improves the training of teenagers, whether the length of the training period is appropriate or excessive, and whether it causes employers to hire teenagers eligible for the subminimum wage instead of adults who are not.

- If the level of the minimum wage simply kept pace with inflation since 1981, it would be an estimated $5.02 an hour in 1991.[24] The new law's 1991 minimum wage of $4.25 an hour, will be 77 cents an hour -- or 15 percent -- below this level.

- In 1991, full-time work at the minimum wage will equal just 81.3 percent of the estimated poverty line for a family of three -- and will leave a family of three $2,000 below the poverty line (see Figure 5).

Figure 5
Minimum Wage vs. Three-Person Poverty Line
(Earner Works Full Time Year Round), 1960 - 1991



[24] This calculation is based on the Congressional Budget Office's inflation projections for 1989, 1990, and 1991.

Achieving the Goal

To achieve the policy goal of ensuring that full-time work provides a route out of poverty, more of the ground lost to inflation in the 1980s would need to be made up after 1991. At that time, restoring the minimum wage to its average value during the 1960s and 1970s should be considered. At that level, full-time work at the minimum wage again would provide enough income to lift a family of three out of poverty.

A number of analysts who have studied the relationship of low wage work to poverty have concluded that a minimum wage increase of this dimension is a necessary component of a strategy to reduce poverty among families with full-time workers. For example, poverty expert David Ellwood of Harvard University, in his highly praised book on family poverty published in 1988, recommended that the value of the minimum wage be returned "to the level of the 1970s." He noted that "Without such a change, it is virtually impossible to guarantee that work will pay enough to keep families out of poverty."[25]

More recently, in May 1989, the Ford Foundation released the results of a comprehensive, multi year review of social welfare problems and policies by a panel of distinguished business leaders, scholars, and policy experts. The recommendations of the panel, chaired by Irving Shapiro, former chief executive officer of the duPont Company, include "restoring the purchasing power of the minimum wage to its 1981 level."[26]

Returning the minimum wage to this level would be particularly relevant to nonmetro workers, since they often work at wages so low that full-time earnings do not lift their families out of poverty.

The principal argument advanced in opposition to a higher minimum wage is that by raising the cost of labor, it decreases the demand for labor and hence employment opportunities. In response to this argument, the task for policy-makers should be to set the minimum wage at a level that strikes the appropriate balance between positive income effects and negative employment effects. The adverse effects of restoring the minimum wage to its level of the 1960s and the 1970s are likely to be modest, in part due to expected tight labor markets and fewer youths entering the labor market in the 1990s. (For a detailed analysis of

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[25] David Ellwood, *Poor Support: Poverty in the American Family*, Basic Books, 1988, p. 112.

[26] Ford Foundation Project on Social Welfare and the American Future, Policy Recommendations of the Executive Panel, *The Common Good: Social Welfare and the American Future*, May 1989, p. 55. The purchasing power of the minimum wage in 1981 was below its average purchasing power in the 1970s, but just slightly.

the effects of changes in the minimum wage on job opportunities, see the Center on Budget and Policy Priorities publication "The Minimum Wage and Job Loss."[27])

State Action

In recent years, there has been a marked increase in state-level legislative activity on the minimum wage, in large part because states tired of waiting for the federal government to raise the wage standard. Some 15 states and the District of Columbia now have raised their minimum wages above the $3.35-an-hour federal minimum wage, which remains in effect through March 1990.

Among these 15 states are several that are either highly rural or that contain a significant number of nonmetro residents. In roughly half of these states, about one-third or more of the state's population lives in nonmetro areas.[28] And in some of the less rural states that have raised their minimum wage -- including California and Pennsylvania -- there are sizeable numbers of workers living in nonmetro parts of the state.

While the minimum wage in most of these states will be superseded when the federal minimum wage reaches $4.25 an hour in April 1991, there are two states where the state minimum wage will exceed the 1991 federal standard. In Oregon, where about one-third of the residents live in nonmetro areas, the minimum wage will equal $4.75 an hour in 1991. In Iowa, where 57 percent of the residents live in nonmetro areas, the minimum wage will equal $4.65 an hour in 1992. In all states, covered workers receive the higher of the federal or state minimum wage.

Given the modest restoration under the federal legislation, some additional states may wish to consider raising their minimum wage above the new federal level or providing more comprehensive coverage. Some states may be able to insure, through a combination of state wage and tax policies, that fewer full-time workers live in poverty.

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[27] Isaac Shapiro, "The Minimum Wage and Job Loss," Center on Budget and Policy Priorities, July 1988.

[28] These nonmetro states are Alaska, Iowa, Maine, Minnesota, New Hampshire, Oregon, Vermont, and Wisconsin.

VI. THE COMBINED STRATEGY: EITC EXPANSION AND MINIMUM WAGE RESTORATION

In Chapter II, a goal was cited: if a parent works full time, his or her family should not be poor. At first blush, this may sound like a laudable but largely unattainable objective. Domestic policy is littered with lofty goals for which we seem to lack the resources or the programmatic know-how to reach.

Yet this goal is not especially difficult to attain. If two of the principal reforms discussed in previous chapters -- earned income credit expansion and full minimum wage restoration -- are combined, great progress can be made.

Dimensions of a Combined Package

If the minimum wage were restored to its average level of the 1960s and 1970s, it again would lift a family of three with a full-time minimum wage worker to the poverty line. If the earned income tax credit were expanded and adjusted by family size, so that larger families received more assistance, families consisting of more than three people (and with a full-time minimum wage worker) could be lifted up to or near the poverty line as well.

Such a combined approach would be of particular benefit to the poor in nonmetro areas, where the poverty rate among full-time workers is twice as high as in metro areas. Moreover, nearly one of every four nonmetro family heads who was not ill, disabled, or retired worked full time year round in 1987, compared with one in six such poor family heads in metro areas.

Expanding the earned income credit and fully restoring the minimum wage would not, by themselves, result in the goal being attained. If a combination of wages and earned income credits lifts a family to the poverty line -- but high health care or child care bills consume thousands of dollars of its income -- the family's disposable income still will fall far below the poverty line. Making the dependent tax credit refundable, other measures to make day care of adequate quality available and affordable to low income working parents, and access to health care coverage also are important ingredients of a policy package.

Similarly, if states impose income tax burdens on working poor families, dropping them deeper into poverty, achievement of the goal can be impeded.

Nevertheless, on the wage and income front, earned income tax credit expansion and minimum wage restoration are the basic building blocks.

EITC Expansion Alone Is Not Enough

Some proponents of expanding the earned income tax credit suggest that it could substitute for future restoration of the lost value of the minimum wage. EITC expansion alone, however, would fall well short of assuring that full-time work lifts a family out of poverty. Nonmetro working families that rely on a minimum wage worker would remain far below the poverty line.

For example, while the EITC expansion proposed by Representative Downey would more than double the maximum benefit provided by the EITC, it would leave the after-tax income of a family of three with two children some $560 short of the projected poverty line in 1991 if the parent worked full time at the $4.25-an-hour minimum wage. A family of four with two children and a full-time minimum wage worker would fall $3,620 below the poverty line.

Under the EITC proposal adopted by the House in 1989, the gaps would be even larger. For a family of four with two children age six or over, the gap (with full-time minimum wage work) would equal $4,260. If either of the children were under age six, the gap would drop, but only to $3,830.

In short, an increase in the EITC that would be big enough to achieve the goal of lifting a family of four with a full-time minimum wage worker out of poverty would need to be extremely large -- much larger than any EITC expansion currently under consideration. Indeed, to increase the credit enough to raise a four-person family with a full-time minimum wage worker to the poverty line in 1991 would require nearly *sextupling* the maximum value of the EITC, from a

value of about $1,000 in 1991 (based on current EITC law) to $5,750. This would add billions in new costs.

Given the extremely high costs of an EITC expansion large enough to lift families with a full-time minimum wage worker out of poverty, federal budget constraints dictate that there be a shared public/private responsibility for addressing the problems of the nonmetro working poor. The costs are much too large to be accomplished solely through an expanded public sector program, such as the EITC. Some of the costs need to be shared through a minimum wage increase.

An EITC expansion also would not assist single individuals and childless couples who are low wage workers, since households without dependent children are not eligible for the EITC. Full restoration of the minimum wage would help these workers.

Minimum Wage Restoration Alone Is Not Enough

Full restoration of the value of the minimum wage -- without expansion in the EITC -- also would fall short of the goal; it, too, would leave many full-time working families well below the poverty line. Even if the minimum wage were returned to a level sufficient to lift a family of three with a full-time worker out of poverty, larger working families would remain poor. A family of four with a full-time worker earning a fully restored minimum wage would be left $2,880 below the four-person poverty line in 1991, after the benefits of the current EITC are added and payroll taxes are subtracted.

Future Dimensions of a Combined Package

An EITC expansion may be enacted in 1990 that will complement the minimum wage legislation enacted in November 1989. Such a package could make significant strides toward the goal of assuring that full-time workers are not poor. The goal still would not be achieved, however. The gap between the poverty line and the income of a substantial number of full-time working families would remain wide, even if the largest of the EITC expansions now before Congress were to be adopted.

Further progress on both the EITC and minimum wage fronts appears necessary in subsequent years -- if both nonmetro and metro working families are to be assured that full-time work will provide an exit from poverty.

VII. UNEMPLOYMENT INSURANCE

Low wage workers in general, and the working poor in particular, often are employed in unstable labor markets where they may lose their jobs because their firm's economic situation worsens. The unemployment insurance system provides some of the unemployed with temporary income support, but receipt of unemployment benefits fell sharply in the 1980s. The trend particularly affects nonmetro areas, where the problem of unemployment is more severe than in metro areas but where unemployment insurance coverage is weaker.

The Nonmetro Unemployed

Throughout the 1970s, the nonmetro unemployment rate was lower than the metro rate, although the gap between the two rates began to close in 1977. Since 1980, however, the nonmetro unemployment rate has exceeded the metro rate every year. While the gap between the two rates has closed somewhat since 1986, it remains significant.

- The nonmetro unemployment rate equaled 6.2 percent in 1988, or nearly one percentage point above the metro rate of 5.3 percent.

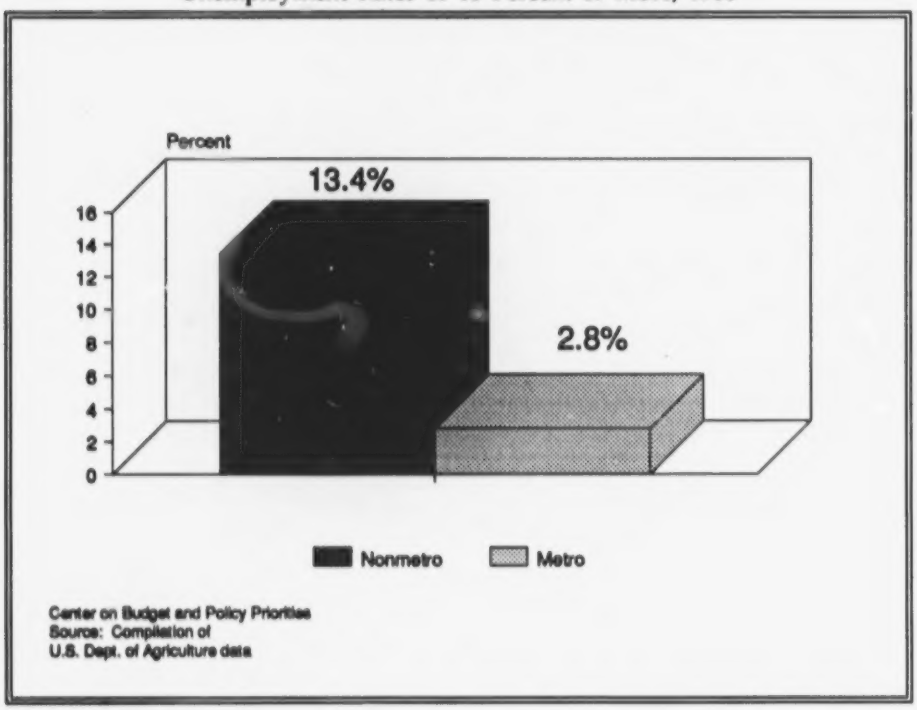
- For the first three quarters of 1989, the nonmetro unemployment rate averaged 5.8 percent while the metro rate averaged 5.2 percent.

Not only are workers more likely to be unemployed in nonmetro areas, but the nonmetro unemployed also are more likely to reside in areas with exceptionally high unemployment rates. In these areas, it may be particularly difficult for unemployed people to find new jobs.

- In 1988, nearly one of every seven people in the nonmetro labor force -- 13.4 percent -- resided in a county with an unemployment rate of 10 percent or more.

- By contrast, in metro areas, fewer than one in every 35 people in the labor force -- 2.8 percent -- resided in counties with double-digit unemployment rates (see Figure 6).

Figure 6
Proportion of Nonmetro Labor
Force Residing in Counties with
Unemployment Rates of 10 Percent or More, 1988



Many of the nonmetro working poor are people who are unemployed for part of the year and working for part of the year. A majority -- 57.3 percent -- of the poor nonmetro household heads who worked in 1987 were employed for less than the entire year.

For all these reasons, the strength of the unemployment insurance system is especially relevant to nonmetro workers, including those who are poor. Since nonmetro workers are more likely than metro workers to be unemployed and to

live in depressed areas where few job opportunities may exist, and since many poor nonmetro workers experience spells of unemployment during a year, the receipt of unemployment insurance can be crucial to these workers and their families.

Background on the Unemployment Insurance System

In recent years, receipt of unemployment insurance has dropped sharply, reflecting policy changes at both the federal and state levels.

The federal government sets broad guidelines for the unemployment insurance program, but many of the key decisions concerning eligibility and benefit levels are made by the states. For example, states determine how long workers must be employed before they become eligible for unemployment benefits when they lose their jobs.

In addition to regular state unemployment benefits, which are provided for up to 26 weeks, federal-state "extended benefits" are provided to a state's long-term unemployed when the state meets certain criteria. When these criteria are met, 13 additional weeks of benefits are provided to those who have exhausted their regular benefits (i.e., to unemployed workers who have been out of work for more than 26 weeks and are still looking for a job).

The federal government and many states enacted changes in the 1980s that restricted coverage under the unemployment insurance programs. At the federal level, the key changes occurred in 1981 as part of budget cuts proposed by the Reagan administration and enacted by Congress that year. Most notably, the criteria that determine when a state can pay extended benefits were made much more restrictive.

As a result, in 1988 only one state -- Alaska -- qualified to provide extended benefits to workers unemployed for more than half a year. Several other states with high unemployment rates and large nonmetro populations -- such as West Virginia with a 9.9 percent unemployment rate and Mississippi with an 8.4 percent rate -- failed to qualify. Overall, nine states had unemployment rates of seven percent or more but did not qualify to provide extended benefits. *Five* of these nine states are among the 15 most rural states in the nation.

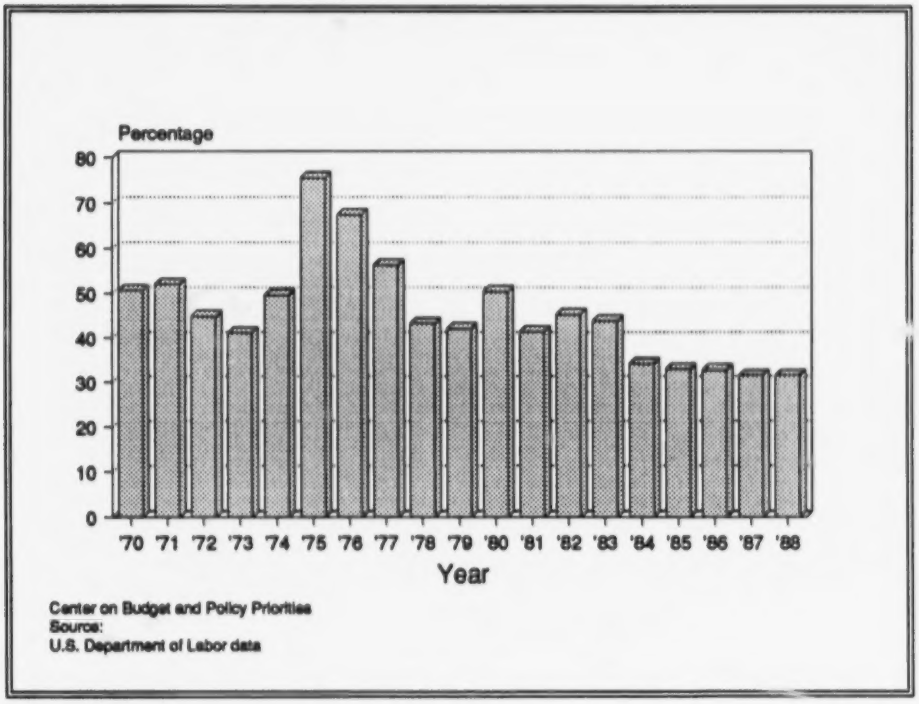
In addition to curtailing extended benefits, the 1981 federal budget cuts required states to pay substantial interest charges on loans from the federal unemployment insurance trust fund unless the loans were repaid quickly. This placed pressure on states to reduce unemployment insurance costs.

Many states added their own restrictions to unemployment insurance programs in the 1980s. Some of these restrictions stemmed from their need to reduce large debts to the federal trust fund to avoid significant interest charges.

Still other factors have influenced the drop in unemployment insurance coverage. These include an increase in the proportion of the unemployed residing in states with low unemployment insurance coverage, along with an increase in the proportion of the unemployed out of work for more than six months. Moreover, a recent study attributes the largest share of the drop in state unemployment insurance coverage to a smaller proportion of those who are eligible actually receiving benefits.[29]

These factors have combined to yield record low proportions of the unemployed receiving benefits (see Figure 7).

Figure 7
Percentage of the Nation's Unemployed Receiving
Unemployment Insurance, 1970 - 1988



[29] Rebecca Blank and David Card, "Recent Trends in Insured and Uninsured Employment: Is There an Explanation," National Bureau of Economic Research, Working Paper No. 2871, March 1989.

- In 1988, only 31.5 percent of the unemployed -- or fewer than one in three -- received unemployment insurance benefits in an average month.

- This coverage rate tied the record low set in 1987 and marked the fifth consecutive year that unemployment insurance coverage set a record low or tied a previous low.

- Prior to this five year period, there was only one other year on record when the coverage rate fell below 40 percent. (These data go back to 1955.)

A further indication of the erosion in unemployment insurance coverage can be found by comparing coverage in 1988, when the national unemployment rate was 5.5 percent, with coverage in 1979, when the unemployment rate was at a similar level (5.8 percent). While only 31.5 percent of the unemployed received benefits in 1988, a substantially larger proportion -- some 42.1 percent -- received benefits in an average month in 1979.

Coverage in Nonmetro States

While unemployment insurance -- or UI -- coverage is low nationwide, there is considerable variation in state coverage rates. State coverage tends to be lower -- and to have fallen more sharply -- in the most rural states.

- In the 10 states with the highest proportions of nonmetro residents, an estimated 28.7 percent of unemployed workers received unemployment benefits in an average month in 1988.

- By contrast, in the 10 states with the lowest proportion of nonmetro residents, 40.2 percent of jobless workers received benefits.[30]

- Furthermore, in five of the 10 most rural states, unemployment insurance coverage declined by 10 percentage points or more from 1979 to 1988. Coverage declined this much in just two of the 10 most urban states. In addition, coverage *increased* from 1979 to 1988 in only one of the 10 most rural states, while it increased during this time period in five of the 10 most urban states (see Table III).

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[30] These are weighted average coverage rates for each of these two groups of 10 states. The unemployment coverage rates for these states were weighted by the number of unemployed workers in each state.

Table III
Unemployment Insurance Coverage
in the Most Rural and the Most Urban States

	Percent of Unemployed Receiving UI, 1988	Percentage Point Change in Coverage from 1979 to 1988	Rank by proportion of population residing in rural areas
Most Rural States			
Idaho	42.2%	-7.5	1
Vermont	50.2	-2.8	2
Montana	30.6	-19.0	3
South Dakota	20.6	-9.8	4
Wyoming	27.6	+0.7	5
Mississippi	22.8	-11.2	6
Maine	41.3	-2.7	7
West Virginia	23.8	-25.0	8
North Dakota	34.2	-17.7	9
Arkansas	29.8	-12.0	10
Most Urban States			
Nevada	31.4	-9.6	41
Pennsylvania	41.6	-10.7	42
New York	46.2	+1.2	43
Massachusetts	57.3	+8.8	44
Florida	17.3	-6.4	45
Rhode Island	72.0	+0.9	46
Connecticut	40.9	+1.4	47
Maryland	25.1	-3.3	48
California	44.1	+1.1	49
New Jersey	47.8	-14.9	50

The Long-term Unemployed

This erosion of the unemployment insurance system -- and, in particular, the severe contraction in benefits for the long-term unemployed – occurred at the

same time long-term unemployment was worsening. In 1979, there were 535,000 people unemployed for 27 weeks or more and still looking for work, constituting 8.7 percent of unemployed workers. But by 1988, the number of long-term unemployed equaled 809,000, or 12.1 percent of the unemployed.

It is likely that a disproportionate share of the rise in long-term unemployment occurred in nonmetro areas. Unemployment is now higher in nonmetro than in metro areas. In 1979 it was lower in nonmetro areas. Moreover, a much higher proportion of unemployed workers in nonmetro areas live in local jurisdictions with especially high jobless rates.

Long-term unemployed workers who do not receive benefits are especially likely to experience economic hardship. A study by an Urban Institute researcher found both that "the long-term unemployed experience very high poverty rates and that UI benefits have a substantial poverty-reducing impact." The study reported that "given the particularly large amount of long-term unemployment experienced in the 1980s, it seems to be clear that UI benefit cutbacks have contributed to economic hardship and to occurrences of poverty in the 1980s."[31]

Reforms

Federal and state policy reforms to strengthen the unemployment insurance system could reduce poverty among unemployed nonmetro workers. At the federal level, one of the most significant reforms for jobless rural workers would be the restoration of the extended benefits program for the long-term unemployed.

The Extended Benefit Program

The key to reforming the extended benefits program is to modify the criteria determining when a state is eligible to pay extended benefits. One possible change that would be especially important for nonmetro areas would be the establishment of criteria on a "substate" basis. Currently, extended benefits can be provided only if the entire state qualifies. Substate criteria would make regions of a state that have exceptionally high unemployment eligible to pay extended unemployment benefits to jobless workers, even if the entire state did not qualify.

Establishing substate criteria would be of disproportionate benefit to the nonmetro unemployed because nonmetro workers are much more likely than

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[31] Testimony by Wayne Vroman, U.S. House of Representatives, Committee on Government Operations, Subcommittee on Employment and Housing, May 22, 1986, p. 11.

metro workers to live in regions with high levels of unemployment. In 1988, some 13.4 percent of the nonmetro labor force resided in a county with a double-digit unemployment rate, while only 2.8 percent of the metro labor force did.

Other reforms could include modifying the formula that determines when a state as a whole qualifies to provide extended benefits.[32] Such a change also likely would prove of particular benefit to the nonmetro poor. As noted, in 1988, nine states had unemployment rates of seven percent or more but did not qualify to provide extended benefits -- and five of these states were among the most rural states in the nation. The five states are Arkansas, Kentucky, Mississippi, New Mexico, and West Virginia. In all of these states, a majority of the population resides in nonmetro areas.

State Policies

State policies largely are responsible for determining eligibility for the basic unemployment insurance program, under which the basic 26 weeks of benefits are

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[32] These reforms could be wholly or partially financed by revising the federal "taxable wage base" for unemployment insurance. Currently, employers must pay federal unemployment insurance taxes of 0.8 percent on only the first $7,000 of an employee's wages. This wage level has not been raised in six years. In inflation-adjusted terms, the $7,000 wage limit is the lowest in the history of the UI program, and is 20 percent lower than in 1983.

(In addition to federal UI taxes, states impose their own UI tax. *State* taxable wage bases are at least as high as the *federal* taxable wage base. However, 35 states have chosen to adopt a taxable wage base above the federal level. Thus, some state UI taxes would be altered by an increase in the federal taxable wage base, while other state UI taxes would not. The average state unemployment insurance tax is 2.4 percent of taxable wages.)

Nationwide, in 1970, some 48 percent of all wages in jobs covered by the UI system were subject to UI taxes. By 1986, the proportion of wages subject to taxation had fallen to 41 percent, and it has declined further since then. An adjustment in the wage base could help finance reforms while also building up the reserves of the unemployment insurance trust fund.

In the spring of 1989, Representative Thomas Downey led an effort both to increase the taxable wage base and to establish substate criteria or "triggers" for determining when to provide extended unemployment insurance benefits in hard-hit areas of a state. Under the Downey proposal, the substate triggers would be established in federal legislation, but it would be up to the governor whether extended benefits would be provided in a part of a state when the substate trigger for that area was reached. (Half of the cost of extended benefits is paid by the state, with the federal government paying the other half.)

The increase in the UI wage base that was contained in the Downey proposal would have raised substantially more in revenue than the substate triggers would have cost. Thus, in addition to making extended benefits available in a number of hard-pressed areas, the proposal would have shored up the UI trust fund.

The proposal passed the Human Resources Subcommittee of the House Ways and Means Committee but fell short in the full Ways and Means Committee by one vote.

provided. Recent changes in these policies have contributed to the erosion in coverage in a number of states.

Of particular importance to low-income nonmetro workers are the state policies that determine the minimum number of weeks that must be worked and the minimum amount of earnings that must be compiled before a worker losing a job can qualify for unemployment insurance benefits. Even though wage levels are lower in nonmetro than in metro areas, the level of earnings required before a worker is eligible for unemployment benefits tends to be *higher* in nonmetro states, thereby excluding many rural workers with low wages. In many nonmetro states, these requirements warrant review to see if they exclude too many low wage workers, especially in nonmetro areas with limited job opportunities.

As this report goes to press, there are indications the economy may be slowing down. The contraction of unemployment insurance coverage will have an especially adverse effect on nonmetro workers if the nation enters another recession or if the rural economy contracts. When the economy is in a downturn, unemployed workers have more difficulty finding jobs quickly and are forced to rely more on unemployment insurance benefits – *if* such benefits are available.

VIII. NON-CASH BENEFITS

While the primary focus of this report is on strategies to assist the nonmetro working poor by raising their cash incomes, several changes at federal and state levels in *non-cash* benefit programs also could be of significance.[33]

In particular, many working poor families that are not receiving welfare also do not receive Medicaid or food stamps. Efforts to extend Medicaid coverage to these families or to raise food stamp participation among these families could have a decided impact on the rural poor.

Medicaid Coverage

A future analysis to be issued by the Center on Budget and Policy Priorities in 1990 will explore health care issues and the nonmetro poor. However, several issues involving Medicaid -- the government health insurance program for low income families and low income elderly and disabled individuals -- deserve mention here because of their direct relevance to the rural working poor.

Many of the *non*-working poor qualify for Medicaid because they receive Aid to Families with Dependent Children benefits. (All families on AFDC are covered under Medicaid.) By contrast, a much smaller proportion of the working poor -- and their children -- have either Medicaid coverage or some other form of health insurance. (Most of the working poor do not receive AFDC, and many low wage jobs do not provide health insurance.)

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[33] Several policy initiatives in the Aid to Families with Dependent Children (AFDC) program also could benefit nonmetro working poor families. These will be covered in a subsequent Center report.

- In 1986, *nearly half* – or 48 percent -- of poor children living in households in which the head worked full time year round were *not covered by any private or public health insurance.*

- Only 18.2 percent of poor children living in a household in which the household head worked full time had Medicaid coverage.

- By comparison, more than three of every five poor children living in a household in which the head did not work – or 60.9 percent -- had Medicaid coverage. Overall, 69 percent of the poor children in non-working households had public or private health insurance.[34]

While coverage figures just for nonmetro areas are not available, the implications of these figures for nonmetro areas are evident. A large proportion of the poor in nonmetro areas consists of working families who do not receive AFDC benefits and, accordingly, are not automatically eligible for Medicaid. As a result, the chances that poor children in nonmetro areas will lack either Medicaid or other health care coverage are high.

This, in turn, leads to an important policy implication: since efforts to extend Medicaid coverage to poor children who do not receive AFDC primarily benefit children in working poor families, such efforts should have an especially large effect in nonmetro areas.

Since 1984, Congress has enacted a series of provisions extending Medicaid coverage to many poor children in families not receiving AFDC. Most notably, legislation enacted in 1989 requires that effective April 1, 1990, states must cover pregnant women and children up to age six living in families with incomes up to 133 percent of the poverty line.[35]

This federal mandate, while significant, encompasses only a fraction of the children in working poor families not receiving AFDC: namely, those below age six. States have the option to extend Medicaid coverage to substantial numbers of other members of poor families, including many poor children age six and over. Some states avail themselves of these options; others do not.

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[34] This data on health insurance coverage are drawn from Deborah Chollet, "Uninsured in the United States: The Nonelderly Population without Health Insurance, 1986," Employee Benefit Research Institute, October 5, 1988.

[35] States also have the option to set the Medicaid income limit for pregnant women and infants under one year old anywhere between 133 percent and 185 percent of the poverty line.

Of the state Medicaid options, one that is particularly significant for the working poor is the option to adopt a "Medically Needy" program. The Medically Needy option allows states to set Medicaid income eligibility limits up to one-third higher than the state's maximum benefit level for AFDC. (Without this option, the Medicaid income eligibility limit for individuals over age five who do not live in households in which the head is elderly or disabled is typically the same as the state's maximum AFDC benefit level. In most states, these benefit levels are far below the poverty line.) If a state uses this option to raise its Medicaid income limit above the AFDC benefit level, more poor families with children become eligible for Medicaid coverage.

Moreover, if a state adopts a Medically Needy program, a family whose "countable" income exceeds the state's Medicaid income eligibility limits, but whose medical expenses are so large that its remaining income after some medical expenses are deducted is below the eligibility limits, becomes eligible for Medicaid coverage for its remaining medical costs.

The Medically Needy option thus allows states to extend Medicaid to a significant number of poor adults and children age six and over who live in families that do not receive AFDC. Most of the families that are covered under this option are working families.

Some 36 of the 50 states do have Medically Needy programs. However, the states that do *not* provide this coverage are disproportionately rural states. Of the 14 states that do not have a Medically Needy program, half are among the 15 most rural states in the nation.

In addition, in many of the rural states that do operate a Medically Needy program, the income eligibility limit for Medicaid is set quite low.

If more states were to adopt a Medically Needy program or to raise their Medicaid income eligibility limits, coverage would be extended to more children in working poor families that lack health insurance.[36]

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[36] There are several other state Medicaid options that affect working poor families. For example, states have the option to extend Medicaid to all children aged six and seven who live in families with incomes up to the poverty line. In addition, in determining Medicaid eligibility for pregnant women, infants, and young children, states have the option of waiving the assets test that is otherwise used as part of the eligibility determination. When the assets test is *not* waived, poor pregnant women and young children whose families meet the income test are nonetheless denied Medicaid coverage if their family's assets exceed the program's asset limits. These limits can be stringent -- and can pose a particular problem for working poor families, who are more likely to have a modest level of resources than nonworking poor families are. (States can waive the assets test either for pregnant women and infants and/or for young children.)

There is also a possible federal policy initiative that could, over time, bridge the health insurance gap for children from working poor families. This is a proposal to require states to extend Medicaid coverage by the year 2001 to all children under age 18 living in families with incomes below the poverty line.[37] Since most poor children under age 18 in *non*-working families are already likely to be covered under Medicaid, the principal effect of this legislation would be to extend coverage to poor children in working poor families that lack health insurance.

This proposal was approved by the House of Representatives in 1989 but dropped in conference with the Senate. It may be reconsidered in whole or in part in future years.[38] It is opposed, however, by the Bush administration and many governors, making prospects uncertain.

Since so many nonmetro poor families work, federal and state Medicaid initiatives such as these would benefit nonmetro poor families to a disproportionate degree.

Food Stamp Outreach to the Working Poor

Another area where states can exercise an option that may disproportionately benefit the nonmetro working poor involves setting up outreach programs to provide information about food stamps.

The food stamp program is somewhat unique among low income benefit programs in that virtually all households that meet the program's income and assets limits may qualify. The composition of the household does not preclude eligibility; it is not necessary to be a single-parent family, a family with children, elderly, or disabled to receive benefits. All that is necessary in most cases is to have low income and limited assets.

The food stamp program is thus one of the principal means-tested programs for which working poor households are eligible. But these households participate in the program only to a limited degree.

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[37] This requirement would be phased in a year at a time; e.g., in 1991, states would be required to cover poor children up to age eight, while poor children up to age nine would have to be covered in 1992. States would also be given the option of extending coverage immediately to all poor children up to age 18.

[38] The legislation was introduced by Representative Henry Waxman, the late Rep. Mickey Leland, and Rep. George Miller. A companion bill was introduced in the Senate by a bipartisan group of senators: Bill Bradley, John Chafee, and Donald Riegle.

A recent study by the U.S. Department of Agriculture, which administers the program at the federal level, found that 60 percent of all eligible households receive food stamp benefits. However, among working households, the participation rates are much lower. Only 37 percent of eligible low income working households receive food stamps.

While there are various reasons why eligible households do not receive food stamp benefits, a number of studies have found lack of information about program eligibility rules to be one of the leading factors. Many households do not know they are eligible. Some apparently believe they must receive AFDC benefits or be jobless to qualify.

From 1971 to 1981, states were required to conduct public information -- or outreach -- efforts to provide information on food stamp eligibility rules and how to apply. Frequently, these efforts were conducted in cooperation with various social service agencies, charities, and nonprofit and religious groups. In 1981, however, the federal government effectively shut down these outreach programs in most areas by withdrawing all federal funds from them. Previously, the federal government had paid half of state outreach costs.

In 1988, the federal government partially reversed course. It passed legislation reinstating federal matching funds for food stamp outreach starting on July 1, 1989 -- and made it a state option as to whether to undertake such efforts. As of December 1, 1989, nine states had announced plans to undertake outreach efforts, while a number of other states reported they were studying the matter but had not yet reached a decision.

Since food stamp participation rates are lowest among the working poor and elderly households, it would be logical for state outreach programs to target these groups. To the degree that states undertake outreach efforts -- and place some emphasis on rural areas -- nonmetro working poor families would stand to benefit.

IX. CONCLUSION

In the United States, a high value is placed on work. This is part of the justification that has been used for a public assistance system that is far less generous to those who are not working than the systems in most other western, industrialized countries.

Yet while the income security provided to non-working families is often meager because of fears about discouraging these families from working, the remuneration received by those who do work can also be rather spartan -- and frequently fails to reflect the philosophical commitment to work our society so often expresses. Many of those families who play by the rules and do work remain impoverished, often living far below the poverty line.

Despite some weaknesses in the nation's economy, we remain prosperous enough that those who work should not have to be poor. Sadly, the opposite is the case today for millions of workers and their families.

Nowhere is this more true than in rural America. The predominant characteristic of the rural non-elderly poor is that they work but still live in poverty. If the federal and state government were to adopt policies to lift the working poor out of poverty, millions of rural residents would gain -- and rural economies would get a boost as well.

For poor people who do not work outside the home, there is considerable debate about what the best policy prescriptions are. But for those who are working, a consensus has emerged in key policy areas. The goal is to "make work pay." By using the readily apparent and available policy tools, we can make a significant dent in the extent and severity of poverty among workers, with the working poor in rural areas among the chief beneficiaries.

Appendix I

Proportion of Each State's Population Residing in Nonmetropolitan Areas, 1987

	Proportion of Population Residing in Nonmetro Areas	Rank (1 equals highest proportion of nonmetro residents)	Number of Nonmetro residents (in thousands)
Idaho	80.4%	1	803
Vermont	76.9	2	421
Montana	75.8	3	613
South Dakota	71.3	4	506
Wyoming	71.0	5	348
Mississippi	69.7	6	1,829
Maine	63.9	7	758
West Virginia	63.7	8	1,209
North Dakota	62.0	9	417
Arkansas	60.5	10	1,444
Alaska	57.6	11	303
Iowa	56.9	12	1,612
Kentucky	54.2	13	2,019
Nebraska	52.8	14	842
New Mexico	51.6	15	774
Kansas	47.2	16	1,169
North Carolina	44.7	17	2,868
New Hampshire	43.7	18	462
Oklahoma	41.2	19	1,350
South Carolina	39.6	20	1,355
Georgia	35.4	21	2,204
Missouri	34.0	22	1,736
Delaware	34.0	23	219
Minnesota	33.8	24	1,435
Wisconsin	33.5	25	1,610
Tennessee	33.0	26	1,603
Alabama	32.8	27	1,338
Oregon	32.4	28	883
Indiana	32.0	29	1,768
Louisiana	31.0	30	1,382
Virginia	28.3	31	1,668
Arizona	23.8	32	805
Hawaii	23.3	33	252
Utah	22.8	34	384
Ohio	21.1	35	2,276
Michigan	19.8	36	1,820
Texas	19.0	37	3,194
Washington	18.8	38	854
Colorado	18.3	39	603
Illinois	17.5	40	2,022
Nevada	17.4	41	175
Pennsylvania	15.3	42	1,828
New York	9.5	43	1,696
Massachusetts	9.3	44	546
Florida	9.2	45	1,110
Rhode Island	7.4	46	73
Connecticut	7.4	47	238
Maryland	7.1	48	322
California	4.3	49	1,182
New Jersey	0.0	50	0
United States	**23.1%**		**56,324**

Source: *Statistical Abstract of the United States, 1989* and U.S. Bureau of the Census

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